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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

JAMES MITCHELL NEWMAN,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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April 8, 1983

QUESTIONS PRESENTED

1. May a conviction of mail fraud be based solely on an employee's unauthorized use of confidential information learned in the course of his employment without any allegation that pecuniary harm was either contemplated or caused?

2. May a conviction of securities fraud under Section 10(b) of the Securities Exchange Act of 1934 be based, notwithstanding *Chiarella v. United States*, 445 U.S. 222 (1980), solely on the unauthorized use of nonpublic "outside" information, without any allegation that the defendant owed any duty of disclosure to any person who purchased or sold securities, or that any such person suffered pecuniary harm?

3. Did petitioner have fair notice that securities trading based on unauthorized use of nonpublic "outside" information was unlawful under federal law where pertinent judicial decisions and Securities and Exchange Commission pronouncements prior to his acts indicated such trades were lawful?

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Petitioner James Mitchell Newman prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case.

OPINIONS BELOW

The United States Court of Appeals for the Second Circuit affirmed petitioner's conviction of mail fraud, 18 U.S.C. § 1341, securities fraud, 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5, and conspiracy to commit mail fraud and securities fraud, 18 U.S.C. § 371. The court of appeals' order, which is unreported, is set forth in the Appendix ("App.") at 1a-3a. A previous opinion of the court of appeals arose on the United States' appeal of the dismissal of the indictment. The district court's opinion dismissing the indictment is set forth at App. 4a-39a. The court of appeals' opinion reinstating the indictment is reported at 664 F.2d 12 (2d Cir. 1981) and is set forth at App. 40a-54a.

JURISDICTION

Jurisdiction to review the court of appeals' February 8, 1983, judgment is vested in this Court by 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND REGULATION INVOLVED

The federal mail fraud statute, 18 U.S.C. § 1341, provides:

> § 1341. *Frauds and swindles*
>
> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b), provides:

> § 78j. *Manipulative and deceptive devices*
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality

of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 of the Securities Exchange Commission ("S.E.C."), 17 C.F.R. § 240.10b-5, provides:

§ 240.10b-5 *Employment of manipulative and deceptive devices.*

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

The decision below broke new ground in the law of both mail fraud and securities fraud. It held for the first time that the mail fraud statute encompasses an employee's unauthorized use of information belonging to his employer even if there was no intended or actual pecuniary loss to the employer. It also is the first decision finding civil or criminal liability under S.E.C. Rule 10b-5 for unauthorized use of nonpublic "outside" information by persons not alleged to have owed any duty to any party to a securities transaction or to the issuer of the securities.[1]

Petitioner James Mitchell Newman has been a professional securities trader for more than 10 years. During part of the period covered by the indictment, petitioner was employed as a securities trader and manager of the

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[1] This case, like *Chiarella v. United States*, 445 U.S. 222 (1980), and *Dirks v. S.E.C.*, No. 82-276 (argued March 21, 1983), involves the expansion of liability under Section 10(b) of the 1934 Act and S.E.C. Rule 10b-5 beyond its traditional scope. Because the court below extended Section 10(b) beyond its commonly understood prohibition against "insider trading" to proscribe trading while in possession of nonpublic "outside" information, it is crucial to understand the terminology used here and in the literature. "Inside" information is "nonpublic information that belongs to and emanates from the corporation whose securities are traded." Barry, *The Economics of Outside Information and Rule 10b-5*, 129 U. PA. L. REV. 1307, 1309 (1981). Inside information generally concerns the internal business affairs of the issuer. An "insider" is a person with a relationship to the issuer "affording access to inside information intended to be available only for a corporate purpose . . . ." *Chiarella*, 445 U.S. at 227. "Outside" information is "nonpublic information created by and belonging to sources outside the issuer." *Barry, supra*, at 1309. Outside information often is not about the internal affairs of the issuer, but may nevertheless be of interest to investors in its securities. *See also* Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 329 (1979); Fleischer, Mundheim & Murphy, *An Initial Inquiry into the Responsibility To Disclose Market Information*, 121 U. PA. L. REV. 798, 799 (1973); Koeltl & Kubek, *Chiarella and Market Information*, 13 REV. OF SEC. REG. 903, 904 (1980).

over-the-counter trading department of a securities broker-dealer; he later left to engage in trading for his own account.

Petitioner and three co-defendants, E. Jacques Courtois, Jr. ("Courtois"), Franklin Carniol, and Constantine Spyropolous,[2] were indicted for mail fraud, securities fraud, and conspiracy to commit mail, wire and securities fraud arising out of certain purchases of stock between 1974 and 1978. App. 55a-78a. The indictment charged that Courtois and Adrian Antoniu ("Antoniu"), an unindicted co-conspirator,[3] "misappropriated"[4] confidential information entrusted to their employers, Morgan Stanley & Co., Inc. ("Morgan Stanley") and Kuhn Loeb & Co. ("Kuhn Loeb"), by their respective clients regarding the plans of those clients to acquire other companies.[5] Since the information originated with the prospective acquirers rather than the prospective targets, it was "outside" information—information of interest to securities traders but not obtained from sources within the issuer. The indictment alleged that Courtois and Antoniu obtained such

[2] Courtois and Carniol reside outside of the United States and have not been extradited for prosecution under the indictment. After petitioner's conviction, Spyropolous entered into a plea bargain with the Government.

[3] Antoniu, apparently the central figure in the alleged conspiracy, entered into a plea bargain with the Government and cooperated in the prosecution of petitioner.

[4] Although the indictment uses the term "misappropriate," it does not allege that information was "taken" in the sense that its "owners" were deprived of that information. Instead, the indictment uses the term "misappropriation" as the equivalent of "misuse" of information, that is, use of information by employees in a manner contrary to that intended by their employers.

[5] Morgan Stanley and Kuhn Loeb are investment banking firms which, among other things, represented companies engaged in corporate mergers, acquisitions, tender offers, or other takeovers. App. 55a-56a. For convenience, they are sometimes hereinafter referred to together as the "investment bankers" or the "employers." Similarly, Courtois and Antoniu are sometimes referred to as the "employees."

information, that Antoniu communicated it to petitioner and others who purchased stock in the target companies, and that Courtois and Antoniu concealed these facts from their employers. Petitioner was the only person tried under the indictment.[6]

The indictment charged that by misappropriating information and failing to disclose the securities purchases to their employers the employees "violated and caused each other to violate the fiduciary duties of honesty, loyalty and silence which each owed" to the employers. App. 60a-61a. Petitioner and the others allegedly "aided, participated in and facilitated Courtois and Antoniu in violating" these fiduciary duties. App. 61a.

The indictment did not assert that Morgan Stanley, Kuhn Loeb, or any of their clients—the alleged victims of the fraud—suffered any economic harm, nor that the alleged scheme contemplated any pecuniary loss on their part. Nor did the indictment charge that any purchaser or seller of securities, or any other participant in any securities transaction, was misled, deceived or defrauded, or suffered any pecuniary loss. The indictment alleged only that petitioner aided two employees in their respective breaches of a duty owed their employers of honesty, loyalty and silence, and that he indirectly used the mails.

District Judge Haight granted petitioner's pretrial motion to dismiss the indictment. Judge Haight found: (i) the Section 10(b) counts failed to state a prosecutable offense because they alleged only a breach of duty owed to persons who were not securities purchasers, sellers or

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[6] Another person who traded on the same information as petitioner, Bruce Steinberg, was not indicted and was advised by the Government that he had not committed any crime. Steinberg testified for the Government under a grant of immunity. Although he testified that he joined petitioner in the purchase of securities of target companies, he was twice told by the Government—on June 20, 1978, and again on April 15, 1981 (after several extensive interviews by prosecutors revealing his activities)—that the prosecution "is not presently possessed of information that Bruce Steinberg has committed a crime." App. 150a-153a.

investors, and such breaches of duty are governed by state law, not the federal securities laws (App. 25a); (ii) the theory of Section 10(b) liability pursued by the Government was so novel that it "does not charge Newman with acts that were proscribed by the securities laws then in force" (App. 27a); and (iii) the mail fraud counts failed to state a prosecutable offense because they were "devoid of any allegation of economic loss, actual or contemplated, on the part of the investment banks or their clients," and that without such allegations "[t]he conduct alleged in the indictment cannot be brought within the mail fraud statute without stretching its terms beyond the degree permitted by basic principles of criminal law." App. 37a-38a.

A divided panel of the Court of Appeals for the Second Circuit reversed the decision of the district court and remanded the case for trial. The majority held that the charges in the indictment "could be found to constitute a criminal violation of section 10(b) despite the fact that neither Morgan Stanley, Kuhn Loeb nor their clients was at the time a purchaser or seller of the target company securities in any transaction with any of the defendants." App. 44a. The majority also summarily rejected Judge Haight's dismissal on the ground of fair notice and due process. App. 49a-50a. The full panel reinstated the mail fraud counts, finding that: "The district court erred in holding that, in every mail fraud case based upon a breach of fiduciary duty by a private employee, there must be proof of 'direct, tangible, economic loss to the victim, actual or contemplated.'" App. 52a.

Following a five-week trial, petitioner was convicted of one count of conspiracy, seven counts of securities fraud and seven counts of mail fraud, all arising out of the breaches of duty by Courtois and Antoniu alleged in the indictment. Petitioner was sentenced to imprisonment for one year and one day, probation for three years thereafter, and a fine of $10,000. Petitioner's second appeal to the Court of Appeals reasserted his argument that the

indictment violated due process and failed to charge crimes under Section 10(b) and the mail fraud statute, and objected to the jury instructions which allowed a conviction under the theories pursued in the indictment. On February 8, 1983, the Court of Appeals for the Second Circuit affirmed petitioner's conviction. App. 1a-3a.

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW RADICALLY EXTENDS THE FEDERAL CRIME OF MAIL FRAUD TO PRIVATE MISUSE OF INFORMATION WITHOUT ANY ACTUAL OR CONTEMPLATED PECUNIARY INJURY TO THE VICTIM.

This petition presents a novel and important question concerning the federal crime of mail fraud. The court below held that an employee's breach of his duty of "honest and faithful service" to his private employer constitutes mail fraud even if the employee neither intends nor causes economic injury to his employer. App. 52a.[7]

This Court declared long ago that mail fraud is "confined to pecuniary or property injury inflicted by a scheme to use the mails for the purpose." *Hammerschmidt v. United States*, 265 U.S. 182, 188-89 (1924).[8] This Court

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[7] The Second Circuit's theory was well-stated in the district court's charge to the jury:

> "[I]t is not necessary, in a mail fraud case based upon a breach of fiduciary duty by a private employee, for the Government to prove direct, tangible, economic loss to the victim, actual or contemplated . . . Schemes designed to deprive its [sic] victims of intangible rights also violate the mail fraud statute." App. 123a.

The district court further charged the jury, in effect, that any deprivation of the employee's "honest services" was sufficient to convict. *Id.*

[8] A recent comprehensive examination of the language and history of the mail fraud statute likewise concluded that Congress intended to incorporate the common law rule that fraud was actionable only where the perpetrator intended to deprive the victim of his money or property. Comment, *The Intangible Rights Doctrine*

has never sustained a mail fraud conviction in the absence of such pecuniary harm.

Until recently, prosecutors and courts generally respected the limits on the mail fraud statute articulated in *Hammerschmidt*.[9] Over the past decade, however, prosecutions under the mail fraud statute have steadily expanded to cover an ever-wider range of activities not before subject to the federal criminal law. "In recent years, . . . the federal mail fraud statute . . . has been expansively interpreted to invite federal prosecution of virtually every type of untoward activity known to man." [10]

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and Political Corruption Prosecutions Under the Federal Mail Fraud Statute, 47 U. CHI. L. REV. 562, 566-78 (1980). The statute proscribes a "scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C. § 1341. The reference to "money or property" in one phrase does not mean that the term "scheme or artifice to defraud" encompasses non-pecuniary injuries. The "money or property" phrase was added in 1909, to codify the holding of *Durland v. United States*, 161 U.S. 306 (1896), that the statute extended to false promises, in addition to fraudulent misrepresentations of fact. *See* Comment, *Intangible Rights*, *supra*, at 570-72. Nothing in *Durland* suggests that the statute extends to schemes or artifices not involving actual or contemplated economic injury.

[9] *E.g.*, *United States v. Regent Office Supply Co., Inc.*, 421 F.2d 1174, 1180 (2d Cir. 1970) (the Government cannot "escape the burden of showing that some actual harm or injury was *contemplated* by the schemer") (emphasis in original).

[10] Hurson, *Limiting the Federal Mail Fraud Statute—A Legislative Approach*, 20 AM. CRIM. L. REV. 423, 424 (1983). The pace and troublesome thrust of this recent trend is reflected in the volume and tenor of this and other recent learned commentary. *See, e.g.*, Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line between Law and Ethics*, 19 AM. CRIM. L. REV. 117 (1981); Rakoff, *The Federal Mail Fraud Statute* (pt. 1), 18 DUQ. L. REV. 771 (1980); Comment, *Intangible Rights*, *supra* note 8; Morano, *The Mail Fraud Statute: A Procrustean Bed*, 14 J. MAR. L. REV. 45 (1980).

The first step in this growth occurred in the area of public official corruption.[11] As Judge Friendly later stated, the "doctrine of the deprivation of honest and faithful services . . . developed to fit the situation in which a public official avails himself of his public position to enhance his private advantage, often by taking bribes." *United States v. Dixon*, 536 F.2d 1388, 1400 (2d Cir. 1976). This extension of the crime of mail fraud rested on the perception that public officials should be held to higher standards of conduct than other individuals: "No trustee has more sacred duties than a public official and any scheme to obtain an advantage by corrupting one must in the federal law be considered a scheme to defraud." *Shushan v. United States*, 117 F.2d 110, 115 (5th Cir.), *cert. denied*, 313 U.S. 574 (1941).

Prosecutors, particularly in the Second Circuit, soon attempted to extend these principles to *private conduct*. In the beginning they were unsuccessful. In *United States v. Dixon*, Judge Friendly recognized that the mail fraud statute did not encompass all violations of duty in the commercial context. He noted that while breaches of private fiduciary obligations violated the mail fraud statute when the purpose of the scheme was "to obtain direct pecuniary gain," a corporate officer's failure to make disclosures to shareholders mandated by S.E.C. rules was not actionable as mail fraud on the theory that the failure to disclose deprived shareholders of the officer's "honest and faithful services." 566 F.2d at 1399-1400.[12] Four years

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[11] In *United States v. States*, 488 F.2d 761 (8th Cir. 1973), *cert. denied*, 417 U.S. 909 (1974), for example, a court of appeals for the first time upheld a mail fraud conviction where the only injury alleged was the deprivation of "intangible" political and civil rights. *States* was soon applied to other cases involving government officials. *E.g.*, *United States v. Mandel*, 591 F.2d 1347 (4th Cir.), *on rehearing en banc*, 602 F.2d 653 (4th Cir. 1979) (per curiam), *cert. denied*, 445 U.S. 961 (1980); *United States v. Isaacs*, 493 F.2d 1124 (7th Cir.), *cert. denied*, 417 U.S. 976 (1974).

[12] The *Dixon* opinion noted that it was unnecessary to determine whether the principle of the political corruption cases that a show-

later, however, in a case involving an alleged *actual loss* to the victim of two million dollars, the Second Circuit declared in dictum that "the object of the fraudulent scheme need not be the deprivation of a tangible interest," but could include an employer's right to the honest and faithful services of his employees. *United States v. Von Barta*, 635 F.2d 999, 1006 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981). The Second Circuit the very next year held that a breach of fiduciary duty was actionable even though it was not causally related to the contemplated injury to the victim. *United States v. Bronston*, 658 F.2d 920 (2d Cir. 1981), *cert. denied*, 456 U.S. 915 (1982). Even in *Bronston*, however, the court recognized that the scheme at issue "was designed to inflict *actual economic harm* on [the victims] and was capable of doing so." *Id.* at 928 (emphasis added).

The line drawn in *Dixon* was abandoned in the present case. Here the Second Circuit upheld the conviction of a private citizen for aiding a purported "fiduciary breach" consisting solely of secret unauthorized use of information in violation of an employee's duty of "honest and faithful service" without requiring the jury to find any contemplated or actual pecuniary harm to the employer.[13] This

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ing of economic harm was not necessary "should be carried over to the private field," *e.g.*, where an element of corruption, such as bribery, was involved. 536 F.2d at 1401.

[13] In cases involving kickbacks or other payments to employees by suppliers, the courts have invoked the deprivation of honest and faithful services rationale. *E.g., United States v. George*, 477 F.2d 508 (7th Cir.), *cert. denied*, 414 U.S. 827 (1973); *United States v. Bryza*, 522 F.2d 414 (7th Cir. 1975), *cert. denied*, 426 U.S. 912 (1976). Those cases, however, involve economic injury to the employer because the scheme contemplates that the employer will be deprived of discounts that the supplier would presumably otherwise be willing to offer to the employer, but instead pays to the employee. *See United States v. George*, 477 F.2d at 513; *United States v. Bush*, 522 F.2d 641, 648 (7th Cir. 1975), *cert. denied*, 424 U.S. 977

case, in effect, federalizes and criminalizes as "fraud" any violation of a company policy, any employee peccadillo, so long as the bare jurisdictional requirement of a mailing is satisfied.

In marked contrast to this unrestrained lower court expansion of the meaning of "fraud" in the mail fraud context, this Court has in other contexts sought to define with some precision the boundaries of the concept of fraud in federal statutes. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court held that the federal securities law references to fraud incorporated the common law understanding that "fraud" actions require proof of scienter. Then, in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), a civil action, the Court rejected the notion that federal securities law fraud embraced every breach of duty touching a securities transaction—exactly the same breadth that the Second Circuit would now give the *crime* of mail fraud where there is any use of the mails.

If this Court is to prevent the trivialization of the criminal process, it must impose limitations on the mail fraud law akin to those imposed on civil actions under similar federal statutes. As this Court concluded in *Hammerschmidt, supra*, in the area of private conduct such limitations are found in the requirement of pecuniary harm.

(1976) (in kickback case, no need to express opinion on whether pecuniary injury must be shown to establish mail fraud violation, because pecuniary injury was present).

II. THE COURT BELOW IMPROPERLY RESOLVED THE ISSUE LEFT OPEN IN *CHIARELLA v. UNITED STATES* BY FEDERALIZING BREACHES OF DUTY WHOLLY WITHIN THE PROVINCE OF STATE LAW WHICH HAD NO EFFECT ON PERSONS INVOLVED IN SECURITIES TRANSACTIONS.

This petition presents the "misappropriation" issue expressly left open by this Court's recent interpretation of Section 10(b) of the 1934 Act in *Chiarella v. United States*, 445 U.S. 222 (1980). In *Chiarella*, the Court held that Section 10(b) does not impose a duty to "disclose or refrain from trading" on an individual who comes into possession of nonpublic information but is not a corporate insider and has no "special relationship" to the seller of securities.[14] The Court left open the question whether the individual's breach of duty to his employer—from whom he obtained access to material outside information—could provide the basis for a Section 10(b) conviction.[15]

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[14] The Court said that "a purchaser of stock who has no duty to a prospective seller because he is neither an insider nor a fiduciary has been held to have no obligation to reveal material facts." 445 U.S. at 229. The opinion stated that a conviction required proof of a breach of a duty to disclose "arising from a relationship of trust and confidence between parties to a transaction." *Id.* at 230.

[15] The Court found that "[w]e need not decide whether this theory has merit for it was not submitted to the jury." 445 U.S. at 236. Chief Justice Burger, however, wrote in dissent that: "I would read § 10(b) and Rule 10b-5 . . . to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading." 445 U.S. at 240. The prosecutors in this case, by focusing on a failure to disclose the misappropriation to the *employers*, pursued a misappropriation theory different from the Chief Justice's, which creates a duty to disclose to the *sellers* of securities information gained by means of misappropriation.

The Government framed the indictment in this case in order to test the issue left open in *Chiarella*.[16] Its theory below was that a breach of an employee's duty to *his employer*, not alleged to cause any harm to any person involved in a securities transaction, was nonetheless prosecutable under Section 10(b).[17]

A. The Rule Adopted Below Improperly Extends the Federal Securities Laws To Reach Conduct Traditionally Governed by State Law.

The breach of duty alleged by the Government involves only contractual or fiduciary obligations of employees to their employers, not duties created by the federal securities laws. The victims of the conduct—the investment bankers and their clients—were not involved in any of the securities transactions described in the indictment. *See* App. 44a.

The Government did not charge that the use of nonpublic outside information of impending takeover bids was itself unlawful. That is because under *Chiarella*, there being no relationship of trust and confidence between petitioner or the employees and the sellers of secu-

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[16] For this reason, the decision below has been the subject of considerable commentary. *E.g.*, Note, *Trading On Confidential Information—Chiarella Takes An Encore: United States v. Newman*, 56 ST. JOHN'S L. REV. 727 (1982); Recent Developments, 27 VILL. L. REV. 1329 (1982); Note, 13 SETON HALL L. REV. 178 (1982); Recent Decisions, 58 NOTRE DAME L. REV. 132 (1982).

[17] Accordingly, the jury was charged by the district court as follows:

> "The Government does not charge in this case that the persons from whom Mr. Newman purchased stocks in the target company were themselves defrauded. . . . This indictment charges that Mr. Newman and the other individuals referred to defrauded, not the sellers of the target companies' stock but rather Morgan Stanley, Kuhn, Loeb and their corporate clients." App. 120a-121a.

rities, petitioner had no duty to disclose material nonpublic information or refrain from trading. *See* 445 U.S. at 228. Petitioner's prosecution rested solely on the allegation that the use of this information for securities purchases had not been authorized by the employers, and that his colleagues had failed to disclose that use to them. *See* App. 137a. No person engaging in a securities transaction was alleged to have been misled by this breach of duty to the employers; there was no contention that had there been disclosure of the unauthorized transactions to the employers, any market trade would have been affected.

The misappropriation of information alleged here is the type of conduct that traditionally has been the province of state law governing employee-employer relationships and commercially sensitive information. The rule adopted below would change this. It would impose, under Section 10(b), a federal securities law standard of conduct for such matters.[18] The federalization of these relationships merely because after the alleged breach of duty the information was used in otherwise lawful securities transactions is clearly beyond the intended scope of the securities laws.

This Court declared in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), that even breaches of fiduciary duty directly affecting securities transactions registered under the 1934 Act do not constitute violations of Section 10(b) when the breach is of a type that falls within the traditional framework of state law. In *Santa Fe*, the Court reasoned that applying Rule 10b-5 under these circumstances "would be to bring within the Rule a wide variety of corporate conduct traditionally left to

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[18] *See* Note, *Trading On Confidential Information—Chiarella Takes An Encore: United States v. Newman*, 56 ST. JOHN'S L. REV. 727, 735 (1982) ("the Second Circuit has transformed an employee's fiduciary obligations into the status of a new federal securities law duty").

state regulation," and that "the extension of the federal securities laws would overlap and quite possibly interfere with state corporate law." 430 U.S. at 478-79. Accordingly, "[a]bsent a clear indication of congressional intent," the Court was "reluctant to federalize" state corporation law, "particularly where established state policies of corporate regulation would be overridden." *Id.* at 479.[19]

The *Sante Fe* decision has direct application here. The conduct at issue here involves matters traditionally governed by state law—here the law of the State of New York. The court below circumvented the limitations of state law[20] by adopting the strained theory that Section

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[19] The district court's original dismissal of the indictment relied in part on this point. The court stated:

> "While the acquiring corporations and investment bankers were damaged . . . insofar as they were deprived of their agent's duty of loyalty and ethical behavior, they were not damaged in their role as future investors in the target companies. While injury of the latter type falls generally within the domain of federal law, the former category is more appropriately governed by state law." App. 25a.

[20] The New York Penal Law makes it unlawful (1) to engage in a course of conduct with intent to defraud persons or to obtain property from persons by false or fraudulent pretenses, *and* (2) to obtain property by such means from these persons. N.Y. PENAL LAW § 190.60 (McKinney 1982 Supp.). It is unlikely that the employees violated this or any other New York Penal Law governing theft of property because they did not "obtain property" as defined under the statute, nor did they intend to "deprive" the employers of property as required to commit larceny. *See* N.Y. PENAL LAW §§ 155.00(1), (2), (3), 155.05, and 165.07 and comments thereon (McKinney 1975). Neither would the employees' alleged breach of duty constitute actionable civil fraud. *See, e.g., Mallis v. Bankers Trust Co.*, 615 F.2d 68, 80 (2d Cir. 1980); *Morrison v. National Broadcasting Co.*, 266 N.Y.S. 2d 406, 410 (S. Ct. 1965), *rev'd on other grounds*, 280 N.Y.S. 2d 641 (1967). The investment bankers and their clients could, of course, pursue state law causes of action other than fraud or deceit, including claims for breach of contract or an equitable accounting for profits obtained through the use of confidential corporate information. *See, e.g., Diamond v. Oreamuno*, 24 N.Y.2d 494, 248 N.E.2d 910 (1969).

10(b) applied because the "proceeds" of the employees' misappropriation—information—were used to determine which securities petitioner bought. In so holding, Judge Van Graafeiland, writing for a divided panel, reversed the district court's finding "that fraud perpetrated upon purchasers or sellers of securities is a 'requisite element under the securities laws.'" App. 46a.[21] Citing this Court's decision in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1972), the majority ruled that any fraud on a person not engaged in securities trading becomes a Section 10(b) violation if the fraudulent activity "touches" upon the purchase or sale of securities. App. 48a-49a. This conclusion both misconstrues *Superintendent* and ignores this Court's subsequent admonitions in *Santa Fe* against federalizing state law.[22]

In *Superintendent*, this Court found Section 10(b) liability where a seller of Government bonds was "duped" through deceit by its fiduciary into making a sale because it was fraudulently misrepresented that the seller would receive the proceeds. 404 U.S. at 9. Liability attached in *Superintendent* because the seller "*was injured as an in-*

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[21] Judge Dumbauld dissented from this aspect of the court's opinion, noting "a trend to confine the scope of § 10(b) to practices harmful to participants in actual purchase-sale transactions." App. 53a.

[22] Judge Van Graafeiland also erred by equating the alleged misappropriation with fraud. Pressed by this Court's statement in *Chiarella* that "Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud," 445 U.S. at 234-35, he assumed without discussion that an employee's misuse of confidential corporate information, like embezzlement of corporate property, was fraud. App. 46a-47a. But this Court made it clear in *Santa Fe* that the term "fraud" in Rule 10b-5 cannot be used "to bring within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction." 430 U.S. at 472. The acts of the employees in this case were at most—even if they had fiduciary rather than mere contractual obligations—breaches of fiduciary duty.

vestor through a deceptive device which deprived it of any compensation for the sale of its valuable block of securities." *Id.* at 10 (emphasis added). The Court concluded that "[t]he crux of the present case is that [the seller] suffered an injury as a result of deceptive practices touching *its sale of securities as an investor*." *Id.* at 12-13 (emphasis added). Clearly, *Superintendent* did not set forth an expansive "touch" test of the type adopted by the Second Circuit here. Nor does it otherwise support a finding of Section 10(b) liability where, as in this case, the Government scrupulously avoided any allegation that the fraud ever deceived any person with an investment interest or participation in the securities transactions that followed the alleged misappropriation.[23] Indeed, neither this nor any other court has ever held Section 10(b) applicable where the victim did not participate in, or have any investment interest in, an affected securities transaction.[24]

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[23] *See* Recent Developments, 27 VILL. L. REV. 1329, 1346 (1982) ("a careful reading of [*Superintendent*] indicates that the fraud must result from deceptive practices 'touching' the purchase or sale of securities *of the defrauded party*") (emphasis in original).

[24] *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737-38 (1975); *United States v. Naftalin*, 441 U.S. 768 (1979). In *Naftalin*, referenced by the court below (App. 49a), this Court reaffirmed the view that a prerequisite for "securities" fraud is deceit of a person in connection with his or her participation in securities trading, when it held that Naftalin violated Section 17(a)(1) of the Securities Act of 1933 because the terms of the statute were "expansive enough to encompass the entire selling process, including the seller/agent transaction." 441 U.S. at 773. *See also Ketchum v. Green*, 557 F.2d 1022 (3d Cir.), *cert. denied*, 434 U.S. 940 (1977); *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654, 659 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) (opinion of Stevens, J.); *Vincent v. Moench*, 473 F.2d 430, 434-35 (10th Cir. 1973); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971) (Congress intended Section 10(b) to apply to deceit "of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities").

In sum, the rule of law adopted below gave Section 10(b) and Rule 10b-5 unprecedented breadth to cover conduct traditionally governed by state law. This Court should review the fundamental question it raises regarding the appropriate scope of federal securities fraud prosecutions.

B. Determination of the Validity of the Government's "Misappropriation" Theory Is Vital to the Securities Industry.

The Government's contention is that "a stock purchase on misappropriated information is in itself a form of fraud and deception as against the rightful owner of the information" creating liability under Section 10(b) and Rule 10b-5.[25] That theory represents a broadening of Section 10(b) liability which is of grave import to the securities industry. The concept of the misuse of information can be so elusive, both in the definition of information covered and the determination of its appropriate use, that the expansion of Section 10(b) liability on the misappropriation theory could have the counterproductive effect on the securities industry of chilling legitimate and productive information-gathering activities.

In the normal course of their employment, many persons in the industry routinely have access to nonpublic outside information. Investment bankers, for example, gain access to information in the course of providing professional services relating to the full range of corpo-

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[25] *See* Brief for the United States of America in *United States v. Newman*, Docket No. 81-1225, at 27. *See also Tender Offers*, Sec. Exch. Act Rel. No. 6239, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82646 at 83456 (Sept. 4, 1980) (". . . persons who unlawfully obtain or misappropriate material, nonpublic information violate Rule 10b-5 when they trade on such information"). The Court of Appeals for the Second Circuit has adopted this theory. *See* App. 44a; *United States v. Chiarella*, 588 F.2d 1358, 1368 n.14 (2d Cir. 1978), *rev'd on other grounds*, 445 U.S. 222 (1980).

rate finance transactions.[26] Likewise, the job of securities analysts is constantly to seek nonpublic information regarding publicly-traded companies. Often they gather it by pressing company personnel and other industry sources for nonpublic news of general applicability or pertaining to the prospects of particular businesses. Such research is crucial to the effectiveness of the securities marketplace. Their inquiries are hardly limited to information of potential or impending takeover efforts, as in this case. Other areas of obvious interest include such information as changes in the levels of orders for certain products or services; price forecasts for various commodities; impending awards of major commercial contracts; changes in key personnel; breakthroughs in research and development; and so forth.[27] In addition to such analysis, the market role of some persons *requires* that they trade on nonpublic outside information, *e.g.*, the stock exchange specialist. *See Chiarella, supra*, 445 U.S. at 233-34 n.16.

The Government's misappropriation theory, particularly when applied in a prosecution for aiding and abetting,

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[26] *See Walton v. Morgan Stanley & Co.*, 623 F.2d 796 (2d Cir. 1980), where it was held that an investment banker may trade on nonpublic *inside* information obtained at arm's length from the issuer.

[27] *See* Barry, *The Economics of Outside Information and Rule 10b-5*, 129 U. PA. L. REV. 1307, 1314 n.43 (1981):

> "Corporations, their associates, and their employees continuously create or receive from countless outside sources information that may affect dramatically the fortunes of competitors, customers, and suppliers. Advance information accessible to even the itinerant salesman about new products, new contracts, accidents, bankruptcies, and other events may have great value to someone trading in the stock of companies only indirectly affected."

Accord, Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 331 (1979).

creates a new risk of prosecution for securities analysts, specialists and other professional traders performing their proper role in the market: ascertaining, disseminating, and utilizing market information.[28] By creating disincentives for these activities, a rule of this breadth could seriously impair the ability of market intermediaries to disseminate pertinent market information. It should be reviewed by this Court before it has widespread application.

III. PETITIONER'S CONVICTION VIOLATES DUE PROCESS OF LAW BECAUSE HE WAS INDICTED AND CONVICTED UNDER SECTION 10(b) FOR CONDUCT NEVER BEFORE HELD TO BE A CRIME, AND AT THE TIME REASONABLY BELIEVED TO BE LAWFUL.

District Judge Haight, declaring that "man's free choice must be guided and informed by legislative prohibitions which are clear, definite and precise" (App. 9a-10a), initially dismissed the indictment against petitioner because "there was no 'clear and definite statement' in the federal securities laws which both antedated and proscribed the acts alleged . . . ." App. 25a. In so concluding, Judge Haight took special note of *Chiarella*, in which, as noted above, this Court made clear that the "misappropriation" theory, under which petitioner was subsequently indicted and convicted, represented a novel ap-

[28] The S.E.C. stated in *In re Dirks*, Sec. Exch. Act Rel. No. 17480, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,812 at 83,945 (Jan. 22, 1981), *aff'd*, 681 F.2d 824 (D.C. Cir. 1982), *cert. granted*, 103 S. Ct. 371 (1982), that securities analysts "actively seek out bits and pieces of corporate information not generally known to the market for the express purpose of analyzing that information and informing their clients who, in turn, can be expected to trade on the basis of the information conveyed. The value to the entire market of these efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by such efforts to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors."

plication of Section 10(b) the propriety of which was expressly not addressed by the Court. App. 10a-11a.[29] Justice Stevens, while agreeing that the Court should not reach the issue, found that "[r]espectable arguments could be made in support of either position" for or against the criminal application of Section 10(b) to an employee's breach of the duty of silence owed to his employer. 445 U.S. at 238.

The Court in *Chiarella* also responded to Justice Blackmun's dissenting argument for adoption of a broad standard of liability for trading on nonpublic outside information as follows:

> "[A] judicial holding that certain undefined activities 'generally are prohibited' by § 10(b) would raise questions whether either criminal or civil defendants would be given fair notice that they have engaged in illegal activity. *Cf. Grayned v. City of Rockford*, 408 U.S. 104, 108-09 (1972)." 445 U.S. at 235 n.20.[30]

Grayned is but one of many cases which uniformly hold that penal statutes not providing reasonable notice to men of common intelligence of the unlawfulness of their acts violate the fundamental constitutional guarantees of due process.[31] Under this same standard, novel

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[29] In *Chiarella*, because "[t]he jury was not instructed on the nature or elements of a duty owed . . . to anyone other than the sellers," this Court declined to "speculate upon whether such a duty exists, whether it has been breached, or whether such a breach constitutes a violation of § 10(b)." 445 U.S. at 236-37.

[30] The Court also took note of the fact that Chiarella's prosecution was "apparently the first case in which criminal liability has been imposed on a purchaser for § 10(b) nondisclosure." 445 U.S. at 235 n.20. After the Court's reversal in *Chiarella*, petitioner stands in Chiarella's position as a test case for a new Government theory of Section 10(b) criminal liability.

[31] In *Grayned*, the Court declared that "[i]t is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined . . . [B]ecause we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a rea-

applications of valid statutes to new and unpredictable circumstances equally transgress the due process requirement of fair notice of illegality.[32]

Petitioner, of course, was indicted and convicted for stock purchases which occurred between 1974 and 1978, well before the Court's introduction to this novel issue in *Chiarella*, and well before any court had found Section 10(b) applicable to trading on misappropriated outside information.[33] Indeed, to this date the only court that

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sonable opportunity to know what is prohibited, so that he may act accordingly." 408 U.S. at 108. *Accord, Dunn v. United States*, 442 U.S. 100, 112-13 (1979); *United States v. Harriss*, 347 U.S. 612, 617 (1954); *Lanzetta v. New Jersey*, 306 U.S. 451, 453 (1939); *Connally v. General Construction Co.*, 269 U.S. 385, 391 (1926).

[32] *See Bouie v. City of Columbia*, 378 U.S. 347, 350 (1964). The due process issue is not, as the S.E.C. argued in its *amicus* brief to the Second Circuit, whether or not petitioner or his alleged co-conspirators knew that their conduct was on the borderline of the law and therefore took actions to maintain the secrecy of their activities. *See* Brief for the Securities and Exchange Commission, *Amicus Curiae*, Docket No. 81-1225 at 12-13 (June 29, 1981). This Court wrote in *Bouie* that "[t]he determination whether a criminal statute provides fair warning of its prohibitions must be made on the basis of the statute itself and the other pertinent law, rather than on the basis of an *ad hoc* appraisal of the subjective expectations of particular defendants." 378 U.S. at 355-56 n.5.

[33] Previous judicial pronouncements on the issue of "insider" trading reflected, if anything, a general view that petitioner's trading on nonpublic *outside* information did not constitute a Section 10(b) violation. *See General Time Corp. v. Talley Industries, Inc.*, 403 F.2d 159, 164 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969) ("We know of no rule of law . . . that a purchaser of stock, who was not an 'insider' and had no fiduciary relation to a prospective seller, had any obligation to reveal circumstances that might raise a seller's demands and thus abort the sale"); *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 890 (2d Cir. 1972) ("The essential purpose of Rule 10b-5, as we have stated time and again, is to prevent corporate insiders and their tippees from taking unfair advantage of the uninformed outsider"); *SEC v. Great American Industries, Inc.*, 407 F.2d 453, 460 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 920 (1969) ("to read Rule 10b-5 as placing an affirmative duty of disclosure on persons who in contrast

has approved this application of Section 10(b) is the Second Circuit Court of Appeals when it decided petitioner's appeal. Moreover, as Judge Haight's district court opinion explained at some length, contemporaneous analyses of the law in this area by the securities bar and even the S.E.C. itself during the years preceding petitioner's purchases reveal that no one then contemplated that trading on material nonpublic outside information was prohibited by Section 10(b). *See* App. 15a-25a. It was not until 1980, after a decade of consideration, that the S.E.C. prohibited the conduct addressed in petitioner's indictment. *See* 17 C.F.R. § 240.14e-3.

Based upon these considerations, the district court concluded that:

> "[T]here was no 'clear and definite statement' in the federal securities laws which both antedated and proscribed the acts alleged in this indictment. As of the times alleged, neither courts, commentators, nor the SEC in its rule-making or enforcement capacities had stated that Rule 10b-5 extended to a noninsider's breach of a fiduciary duty owed to the acquiring corporation in a tender offer. To the extent the question was addressed at all, the indications . . . were quite to the contrary. While the SEC has concerned itself with the general subject of tender offers at least since the enactment of the Williams Act in 1968, the conduct sought here to be prosecuted was not proscribed until 1980, when Rule 14e-3 was promulgated. Prior to that time, the absence of such a rule, particularly when viewed in the context of the SEC's inquiry to the industry as to whether one should be adopted, precludes criminal prosecutions for what is, in effect, unproscribed conduct." App. 25a.[34]

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to 'insiders' or broker-dealers did not occupy a special relationship to a seller or buyer of securities, would be occupying new ground and would require most careful consideration").

[34] *Compare United States v. Chiarella*, 588 F.2d at 1376-77 (Meskill J., diss.).

The court of appeals barely addressed the key due process issue raised in Judge Haight's district court opinion. Its sole discussion of the issue of fair notice was its conclusory finding that "Rule 10b-5's proscription of fraudulent and deceptive practices upon any person in connection with the purchase or sale of a security provided clear notice to appellee that his fraudulent conduct was unlawful." App. 49a-50a.

In view of the cursory consideration apparently given this issue by the court of appeals, and petitioner's impending imprisonment, this Court should grant certiorari to provide review befitting the grave issue of due process of law that is presented.

CONCLUSION

For the reasons set forth above, certiorari should be granted to review the judgment of the court of appeals.

Respectfully submitted,

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April 8, 1983

82-1653

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

JAMES MITCHELL NEWMAN,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the eighth day of February, One Thousand Nine Hundred and Eighty-three.

Present:

HON. WILLIAM H. TIMBERS,
HON. ELLSWORTH A. VAN GRAAFEILAND,
HON. GEORGE C. PRATT,
Circuit Judges

82-1273

UNITED STATES OF AMERICA,
Appellee,
v.
JAMES MITCHELL NEWMAN,
Appellant.

[Filed Feb. 8, 1983]

ORDER

James Mitchell Newman appeals from a judgment entered after a jury trial in the United States District Court for the Southern District of New York, Charles S. Haight, J., convicting him of mail fraud and securities fraud, 18 U.S.C. § 1341 (1976), 15 U.S.C. § 78(j)(b) (1976), 17 C.F.R. § 240.10b-5, and conspiracy to commit mail fraud and securities fraud, 18 U.S.C. § 371 (1976). We affirm.

We find no merit in Newman's contention that the mailings which the Government proved were not in furtherance of a scheme to defraud within the meaning of the mail fraud statute. Newman's scheme contemplated the purchase by Bermuda trusts of the stock of corporation takeover targets, whose identities Newman had attained illegally, and the sale of such stock at a profit when takeovers took place. Customary business correspondence between the purchasing brokers and the Bermuda trustees was an integral, clearly foreseeable part of these transactions. *Pereira v. United States*, 347 U.S. 1, 8-9 (1954); *United States v. Muni*, 668 F.2d (2d Cir. 1981); *United States v. Hasenstab*, 575 F.2d 1035, 1037 (2d Cir.), *cert. denied*, 439 U.S. 827 (1978). Confirmations of purchase are customary in the brokerage business. Newman's argument that his fraudulent scheme came to an end with the broker's purchase of the stock is completely without merit. *See United States v. Kenofskey*, 243 U.S. 440, 443 (1917); *United States v. Huber*, 603 F.2d 387, 399-400 (2d Cir. 1979), *cert. denied*, 445, 927 (1980); *United States v. Cyphers*, 556 F.2d 630, 632-34 (2d Cir. 1977), *cert. denied*, 431 U.S. 972 (1977) and 436 U.S. 950 (1977).

The only evidentiary ruling of which appellant complains is not erroneous. Judge Haight admitted into evidence several investment banking memoranda which instructed employees on the importance of preserving client confidences. Appellant argues that the jury might have considered these memoranda to be statements of law and asserts that they were incorrect statements of the then-existing law. However, Judge Haight, both at the time that portions of the memoranda were read to the jury and in his final charge, carefully instructed the jury that the memoranda were to be considered only as probative of what investment bank employees were told by their employers concerning the misuse of confidential information. The judge told the jury that he would instruct them on the law and he did so. There was no error here.

We have examined carefully the district court's instructions to the jury, and we find that they carefully and correctly stated the law relating to mail and securities fraud. Appellant's several assertions of error are baseless. In substance, appellant is simply rearguing issues decided against him on the prior appeal.

The judgment of conviction is affirmed.

/s/ Wm. H. Timbers
HON. WILLIAM H. TIMBERS

/s/ E. A. Van Graafeiland
HON. ELLSWORTH A. VAN GRAAFEILAND

/s/ George C. Pratt
HON. GEORGE C. PRATT

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

S81 Cr. 53-CSH

UNITED STATES OF AMERICA

—against—

E. JACQUES COURTOIS,
JAMES MITCHELL NEWMAN, a/k/a "Barnett,"
FRANKLIN CARNIOL, and
CONSTANTINE SPYROPOULOS, a/k/a "Patrick,"
Defendants.

MEMORANDUM OPINION

Appearances:

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HAIGHT, *District Judge*:

James Mitchell Newman, the only defendant in this four-defendant indictment presently before the Court,[1] moves to dismiss the indictment as to him on the ground that the acts charged did not constitute criminal conduct at the times of their occurence.

I.

The indictment, charging defendants with violations of the mail fraud statute, 18 U.S.C. § 1341, and § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), together with SEC Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5,[2] as well as conspiracy to commit these substantive violations, 18 U.S.C. § 371, describes a scheme perpetrated in 1976, 1977, and 1978.[3] Defendant Courtois was a member of the merger and acquisition department of Morgan Stanley & Co., Inc. ("Morgan Stanley"), an investment banking firm. On July 1, 1977 he was made vice-president of that department. One Adrian Antoniu, an indicted co-conspirator now cooperating with the Government, held a comparable if less exalted position at the investment banking firm of Kuhn, Loeb & Co., later known after merger with another firm as Lehman Brothers Kuhn Loeb Inc. ("Kuhn Loeb"). As a result of

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[1] Defendants E. Jacques Courtois, Jr., Franklin Carniol, and Constantine Spyropoulos have left the United States. The Government is attempting to extradite them for arraignment, to date without success.

[2] Section 32(a) of the 1934 Act sanctions criminal penalties against any person who wilfully violates the Act. 15 U.S.C. § 78ff(a) (1976 ed., Supp. II).

[3] The recitation which follows summarizes the indictment, which is of course no more than an accusation. The Court intimates no view upon the factual accuracy of the account given in the indictment, or upon the guilt or innocence of any defendant. For the purpose of testing the legal sufficiency of the indictment, the facts recited are assumed to be true.

their positions, Courtois at Morgan Stanley and Antoniu at Kuhn Loeb acquired confidential, non-public information concerning possible mergers, acquisitions, tender offers or other takeover bids for publicly held companies ("target companies"). Courtois and Antoniu misappropriated certain of this information which, in furtherance of the conspiracy, was communicated to co-conspirators Newman, Carniol and Spyropoulos. The latter, using methods designed to conceal their activities, purchased shares of the target companies. When the proposed takeovers became known to the public, and the targets' stock predictably increased in value, the conspirators sold out and divided the spoils.

By entering into these arrangements, the Government charges in count 1 of the indictment, the defendants conspired to violate the mail fraud statute, 18 U.S.C. § 1341,[4] as well as § 10(b)[5] and Rule

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[4] 18 U.S.C. § 1341 provides:

"Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both."

[5] Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce

10b-5.[6] Counts 2-14 charge 13 substantive violations of the mail fraud statute. Newman is named with Courtois in counts 2, 3, 5, 7, 9, 11 and 13. Counts 15-27 charge 13 substantive violations of § 10(b) and Rule 10b-5. Newman is named with Courtois in counts 15, 16, 18, 20, 22, 24 and 26.

Newman contends that the acts charged do not constitute violations of any federal criminal statute, so that all substantive counts fall, and the conspiracy count with them. Following the order adopted by the parties in their briefs, I consider first the § 10(b) counts, and then the mail fraud counts.

II.

Consideration of the § 10(b) and Rule 10b-5 counts necessarily begins with *United States v. Chiarella*, 445

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or of the mails, or of any facility of any national securities exchange—

* * *

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

[6] Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

U.S. 222 (1980). Chiarella was an employee of a financial printer retained by corporations to print, *inter alia*, documents relating to proposed takeovers. The names of the targets were blanked out, but Chiarella penetrated the security, learned the targets' identity, purchased their stock before the takeovers became publicly known, and sold at a profit thereafter.

The Government procured an indictment of Chiarella on the theory that his failure to disclose his knowledge of the impending takeovers at the time he purchased shares in the target companies violated § 10(b) and Rule 10b-5. The trial court's charge permitted the jury to convict Chiarella if it found that he wilfully failed to inform sellers of target company securities that he knew of a forthcoming takeover bid that would make their shares more valuable. The jury convicted Chiarella. A divided panel of the Second Circuit affirmed the conviction. 588 F.2d 1358 (2d Cir. 1978).

The Supreme Court posed the issue as follows, at 445 U.S. 224:

> "The question in this case is whether a person who learns from the confidential documents of one corporation that it is planning an attempt to secure control of a second corporation violates § 10(b) of the Securities Exchange Act of 1934 if he fails to disclose the impending takeover before trading in the target company's securities."

Answering that question in the negative, the Court held that Chiarella's conduct did not constitute a violation of § 10(b), and hence his conviction was improper.

While recognizing that Chiarella may have acted unfairly, the Court observed that "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)." 445 U.S. at 232. Chiarella could not be charged with fraud because "the element required to make silence fraudulent—a duty to disclose—is absent in

this case." *Ibid.* "Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." *Id.* at 234-35. Chiarella owed no such duty to the sellers of the target companies' securities for he had had no prior dealings with them and was not their agent, fiduciary, or a person in whom the sellers had placed their trust and confidence. "He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions." *Id.* at 232-33. The Court specifically rejected the Government's concept of "a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.* at 233. Formulation of so broad a duty, departing from established doctrine that duty to disclose arises from a specific relationship between parties, "should not be undertaken absent some explicit evidence of congressional intent." *Ibid.* Reviewing the pertinent statutes, the Court found no such evidence, and at 235 n.20 drew an analogy to the concept of constitutionally impermissible vagueness:

> "Additionally, a judicial holding that certain undefined activities 'generally are prohibited' by § 10(b) would raise questions whether either criminal or civil defendants would be given fair notice that they have engaged in illegal activity. Cf. Grayned v. City of Rockford, 408 U.S. 104, 108-109 (1972)."

Grayned declares that "[i]t is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined . . . [B]ecause we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." 408 U.S. at 108. Furthermore, man's free choice must be guided and informed by legislative prohibitions which

are clear, definite and precise. The moral law may condemn broad courses of conduct; appropriate punishment may await the transgressor elsewhere. But temporal, secular criminal law employs a focus at once more narrow and precise. Judge Meskill, in his prophetic dissent when *Chiarella* was before the Second Circuit, wrote:

> ". . . We cannot uphold a conviction unless 'a clear and definite statement of the conduct proscribed' antedates the actions alleged to be criminal." 588 F.2d at 1376, *quoting United States v. Persky*, 520 F.2d 283, 287 (2d Cir. 1975).

That "clear and definite statement of the conduct proscribed," Judge Meskill continued, "must emanate from the language of the statute itself, from prior judicial interpretation, or from established custom and usage." The Government's charges against Chiarella fell because one could not point to "a sufficiently clear statement prohibiting Chiarella's actions to warrant imposition of a criminal sanction." *Id.* at 1377.

These principles apply with full force to the present indictment, although the Government proceeds upon a different theory. In *Chiarella*, the Supreme Court stated:

> "In its brief to this Court, the United States offers an alternative theory to support petitioner's conviction. It argues that petitioner breached a duty to the acquiring corporation when he acted upon information that he obtained by virtue of his position as an employee of a printer employed by the corporation. The breach of this duty is said to support a conviction under § 10(b) for fraud perpetrated upon both the acquiring corporation and the sellers." 445 U.S. at 235-36.

The Court found it unnecessary to decide whether that alternative theory was viable, since it had not been submitted to the jury, and "we cannot affirm a criminal con-

viction on the basis of a theory not presented to the jury." In those circumstances, the Court declined to "speculate upon whether such a duty exists, whether it has been breached, or whether such a breach constitutes a violation of § 10(b)." *Id.* at 236-37.

It is this theory, not passed upon by the Supreme Court in *Chiarella*, that the Government urges against the present defendants, expanding it to include a fraud upon the employer investment banks as well as their corporate clients. The indictment, tracking the language of Rule 10b-5(a) and (c), charges that the conspirators' actions "operated as a fraud and deceit on Morgan Stanley, Kuhn Loeb, and those corporations and shareholders on whose behalf Morgan Stanley or Kuhn Loeb was acting and to whom Morgan Stanley or Kuhn Loeb owed fiduciary duties." *See, e.g.*, ¶ 9 of the indictment.

Thus the question left open in *Chiarella* is squarely presented here. That is so, notwithstanding the fact that Newman was not an employee of either Morgan Stanley or Kuhn Loeb. Newman formed a different link in the conspiratorial chain, receiving confidential information generated by Courtois and Antoniu. The latter were the faithless employees of Morgan Stanley and Kuhn Loeb, and hence the counterparts to that equally faithless printer, Chiarella. But the Government charges in ¶ 10(d) of the indictment that Newman, together with defendants Carniol and Spyropoulos, "aided, participated in and facilitated Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn Loeb, and clients of those investment banks." Clearly, if Courtois and Antoniu breached duties to their employers and their employers' clients which implicate § 10(b), Newman may be prosecuted as a co-conspirator under 18 U.S.C. § 371, and, on the substantive counts, as an aider and abetter under 18 U.S.C. § 2.

The decisive issue, then, is whether during the period 1976-1978 a "person of ordinary intelligence" [7] could have derived from the 1934 Act, the SEC rules, and Court decisions that the conduct described in the indictment violated § 10(b) and Rule 10b-5.[8]

III.

The Government argues that the breaches of fiduciary duties owed to investment bankers and their clients charged in the indictment are cognizable under § 10(b) and Rule 10b-5. However, to the extent that the Government "would rely on the use of the term 'fraud' in Rule 10b-5 to bring within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction, its interpretation would . . . 'add a gloss to the operative language of the statute quite different from its commonly accepted meaning.'" *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 (1977), *quoting Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). More

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[7] *Grayned, supra.*

[8] The Government, in its Brief at 16-17, contends that this analysis need not be undertaken because there is controlling precedent in this Circuit to support the theory underlying this prosecution. The Government argues that by declining to speculate on the duty, if any, owed to the acquiring corporation and its relationship to Rule 10b-5, the Supreme Court left untouched the following statement in the Second Circuit's opinion approving the theory:

> "Clearly, violation of an agent's duty to respect client confidences, Restatement (2d) Agency § 395, transgresses Rule 10b-5 where, as here, the converted information both concerned securities and was used to purchase and sell securities."

588 F.2d at 1368 n.14 (citations omitted). But the quoted language is no more than *dictum*. The theory was not pleaded in the indictment, presented to the jury, nor argued to the Second Circuit in the briefs, which I have examined. The Government advanced this concept of breach of duty for the first time when *Chiarella* reached the Supreme Court. I regard the question as open in both tribunals.

recently, the American Law Institute, after completing a thorough study of the securities laws in preparation for promulgation of its own proposed securities code, stated that " 'fraud' *still* requires something more than 'unfairness' or breach of fiduciary duty." American Law Institute, Federal Securities Code, *Proposed Official Draft*, § 1603, comment 3(b) (March 15, 1978) (emphasis added); *see id.* comment 3(d).

The "something more" required for fraud in the context of cases of omission is the duty to disclose central to the Court's rationale in *Chiarella*. That duty, in turn, has traditionally been premised

> "on two principal elements: first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing that it is unavailable to those with whom he is dealing. . . . [The] task here is to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities." *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961).

The "special relationship" required by the SEC in *Cady, Roberts* has been found by courts and commentators alike to include only corporate insiders and their tippees trading in that corporation's securities. *See, e.g., Chiarella, supra*, 445 U.S. at 232-235; 1A Bromberg, Securities Law: Fraud, § 7.4(6)(b), at 179-83 (1977); Fleischer, Mundheim & Murphy, *An Initial Inquiry into the Responsibility to Disclose Market Information*, 121 U.Pa.L. Rev. 798, 804 (1973). As Judge Meskill noted in his dissent to the Second Circuit's treatment of *Chiarella*, 588 F.2d at 1374:

> "Eleven years after the *Cady, Roberts* decision this approach to Rule 10b-5 had become so firmly en-

> trenched that this Court remarked: 'The essential purpose of Rule 10b-5, as we have stated time and again, is to prevent corporate insiders and their tippees from taking unfair advantage of the uninformed outsiders.' *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 890 (2d Cir. 1972)."

See also *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968).[9]

In the case at bar, it could not be alleged that Newman was a corporate insider acting on inside information. Rather, he was a peripheral figure, privy by virtue of the conspiracy to "market information"—that is to say, "information about events or circumstances which affect the market for a company's securities but which do not affect the company's assets or earning power," and which emanates from sources other than that company. Fleischer, Mundheim & Murphy, *supra*, 121 U.Pa.L.Rev. at 799, 807. In respect of most of the transactions alleged in the indictment, trading by Newman on the basis of such information could not have violated Rule 10b-5 under the *Cady, Roberts* analysis because Newman had no relationship to the target companies;[10] the information was re-

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[9] The emphasis in the cases on an insider relationship is in accordance with the legislative history of § 10b and Rule 10b-5, which, although it did not address the precise situation of nondisclosure, was highlighted by statements of concern with abuses by corporate insiders. *E.g., Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 85,134-137 (1934) (statement of Thomas Corcoran); S.Rep. No. 792, 73d Cong., 2d Sess. 9 (1934); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13-14 (1934); S.Rep. No. 1455, 73d Cong., 2d Sess. 55-68 (1934); *Stock Market Study: Hearings on Factors Affecting the Buying and Selling of Equity Securities Before the Sen. Comm. on Banking and Currency*, 84th Cong., 1st Sess. 961-65 (1955) (statement of Ralph H. Demmler).

[10] The indictment encompasses 18 "bidding" companies, paired with 18 "target" companies. ¶ 6. The Government says in its brief, p. 7:

ceived, however improperly, from the acquiring corporations; and the securities in which he traded were those of the target companies. *Compare id.* at 812-13.

Both Congress and the SEC in its role as a rule-making authority acting pursuant to congressional mandate have recognized, and attempted to remedy, the problem of misuse of market information. Recognizing "a gap, a rather large gap, in the securities statutes," [11] and the abusive tactics resulting from leaks of impending tender offers,[12] Congress in 1968 enacted the Williams Act, P.L. No. 90-439, which amended the 1934 Act to require, *inter alia*, disclosure in the as yet unregulated field of takeovers. Included among the new additions to the 1934 Act was § 14(e), 15 U.S.C. § 78n(e), which, as originally enacted, stated:

> "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to en-

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"All the eighteen stocks listed in the indictment which the schemers bought on stolen information were stocks in target companies of takeover negotiations or plans. In all cases but two Morgan Stanley or Kuhn Loeb represented the bidding company. In the Pan Ocean takeover, Morgan Stanley represented Pan Ocean. In the negotiations regarding Robintech, Kuhn Loeb represented each side at various points. Kuhn Loeb was also representing a putative target (i.e., a company looking for a buyer) whose stock Newman bought: Great Basin Petroleum."

Neither party deals, in briefs or argument, with the issue of whether different legal consequences arise from an investment bank's representation of a target, as opposed to a bidding, company. See discussion at p. 23, *infra*.

[11] Hearings on S. 510 Before the Sen. Comm. on Banking and Commerce, 90th Cong., 1st Sess. 15 (1967) (statement of then SEC Chairman Budge).

[12] *Id.* at 69 *et passim*.

> gage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation."

But while § 14(e) as opposed to § 10(b) was self-effectuating, problem areas still remained which prompted Congress in 1970 to amend § 14(e) to give the SEC the power to promulgate rules thereunder. One such situation was that in which:

> "The person who has become aware that a tender offer is to be made, or has reason to believe that such bid will be made, may fail to disclose material facts with respect thereto to persons who sell him securities for which the tender bid is to be made."

Hearings on S. 336, S. 3431 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 91st Cong., 2d Sess. 12 (1970) (memorandum from SEC's Division of Corporation Finance). Although the problem was then recognized, it took ten years for a cure to be prescribed in the form of Rule 14e-3, 17 C.F.R. § 240.14e-3.[13] Rule 14e-3 undisputedly renders illegal the

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[13] Rule 14e-3 provides in pertinent part:

> "If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the 'offering person'), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from (1) the offering person, (2) the issuer of the securities sought or to be sought by such tender offer, or (3) any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing

type of conduct allegedly engaged in by Newman. But the SEC did not release the text of the rule until September 4, 1980: several years after the acts alleged in the indictment.

The Government argues that Rule 14e-3 and Rule 10b-5 may overlap. That is true in principle, but relevant to this case only if one assumes the Government's theory that 10b-5 applies to the acts charged. To be sure, in the release accompanying Rule 14e-3, the SEC noted that it "continues to believe" that trading on misappropriated information violates Rule 10b-5. 1934 Act Rel. No. 6239, [1980] CCH Fed. Sec. L. Rep. ¶ 82,646, at p. 83,456 & n.20. But the fact remains that during the preceding ten years, when the need for a rule to prevent advance use of takeover information was being examined thoroughly, the applicability of Rule 10b-5 to situations in which an insider was not involved was, to state the case most favorably to the Government, far from clear. Three factors support this conclusion: the SEC's explicit rejection of Rule 10b-5's applicability to the analogous situation of warehousing; the absence of any reference to Rule 10b-5 in the SEC releases setting forth the proposals for a new rule, and in the responses thereto; and the reliance on a traditional insider analysis or on a breach of a duty owed the other party to the transaction both in judicial opinions and in the enforcement actions brought pursuant to Rule 10b-5 by the SEC prior to the period in question herein. These factors are considered in turn.

"Warehousing" occurs when an acquiring corporation, seeking allies in the forthcoming tender battle, itself leaks information about the impending tender offer to institutional investors. *See* Fleischer, Mundheim & Murphy, *supra*, 121 U.Pa.L.Rev. at 811-12. Of course, the practice differs from the scheme presently alleged: in

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securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise."

warehousing, the acquiring company wants the tender information leaked; here, the tender information was misappropriated from the acquiring company despite its attempts at secrecy. But a key similarity assumes, within the present context, greater significance. Both situations involve trading on nonpublic information in the target company's securities *by persons unaffiliated with the target.* And it is precisely that latter circumstance which caused the SEC to refuse to extend Rule 10b-5 to regulate warehousing:

> "While there may be some similarities between the nondisclosure of information regarding an intention to make a takeover bid for another company and the nondisclosure of material information about a company's business affairs, the two situations involve somewhat different considerations and different underlying principles. With respect to the latter, material undisclosed corporate information, the relevant principle has been developed as an interpretation of Rule 10b-5 and other antifraud provisions. Persons who have acquired material undisclosed information about a company by reason of their relationship with that company (and usually for a corporate purpose) may not utilize this information for their own benefit either by trading themselves or by giving the information to favored investors in order that the investors may use it in their trading.
>
> "With respect, however, to passing on information about a prospective takeover effort to favored institutions, the persons who do so usually are the persons who plan the takeovers and ordinarily have *no relationship to the target company, nor do they usually have any fiduciary duty to that company or its shareholders.* This difference in relationships does not necessarily mean that such passing on of information concerning takeovers should be permitted, but it may well mean that *if such activities are to be prohibited,*

this should be done by a rule specifically directed to that situation rather than by an expanded interpretation of Rule 10b-5 resting on a somewhat different theory than that underlying that rule as to the obligations and duties of those who receive material undisclosed information.

* * * *

"The Commission will, accordingly, consider the possibility of developing appropriate rules to deal with misuse in the market of undisclosed information concerning corporate takeovers. It presumably will be necessary in such rules to *distinguish between persons who receive information on this subject for a legitimate purpose* related to the proposed takeover *and those who are given a 'tip' for some other purpose.* It may also be necessary to distinguish between, on the one hand, persons who in fact are part of the group attempting the takeover, who should be permitted to communicate among themselves and to purchase shares of the target company subject to the requirements of the Williams Act and, on the other hand, *those who are not part of the group but who are given the information for other purposes.*"

Institutional Investor Study Report, H.R. Doc. No. 92-64, 92d Cong., 1st Sess. Part 8, XXXII-III (1971) (emphasis added); *accord*, *General Tire Corp. v. Talley Industries, Inc.*, 403 F.2d 159, 164-65 (2d Cir. 1968) (relying in part on recent enactment of Williams Act to reject contention that Rule 10b-5 prohibited warehousing).[14]

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[14] The Court stated:

"We know of no rule of law, applicable at the time, that a purchaser of stock, who was not an 'insider' and had no fiduciary relation to a prospective seller, had any obligation to reveal circumstances that might raise a seller's demands and thus abort the sale. See Jennings, Insider Trading in Corporate Securities: A Survey of Hazards and Disclosure Obligations under Rule 10b-5, 62 Nw.U.L.Rev. 809, 815 (1968); Bromberg, Securities Law, Fraud, SEC Rule 10b-5, 119, 123-24,

In *Chiarella* the Supreme Court observed that "the theory upon which the petitioner was convicted is at odds with the Commission's view of § 10(b) as applied to activity that has the same effect on sellers," namely warehousing; the Court continued:

> "Significantly, however, the Commission has acted to bar warehousing under its authority to regulate tender offers after recognizing that action § 10(b) would rest on a 'somewhat different theory' than that previously used to regulate insider trading as fraudulent activity." 445 U.S. at 234 (footnote omitted).

The SEC apparently adhered to the view that Rule 10b-5 did not prohibit use of advance knowledge of a tender offer by noninsiders when it asked in 1973 for public comment as to:

> "Whether and to what extent selected, nonpublic knowledge about the existing or future market in particular securities should be treated as material information which must be disclosed by . . . persons prior to any transactions in those securities." 1934 Rel. No. 10316 (Aug. 1, 1973).

The inquiry posed presupposes a vacuum in the securities regulations then existing; surely, had the SEC perceived Rule 10b-5 as providing the answer, it need not have asked the question. Furthermore, none of the releases [15]

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170 (New Matter) (1968). Indeed, secrecy had long been the hallmark of most stock acquisition programs, at least in their initial stages. The very fact that Congress has recently thought it desirable to pass new legislation amending §§ 13 and 14 of the Securities Exchange Act to require disclosure under certain circumstances, P.L. 90-439, 82 Stat. 454, approved July 29, 1968, is an indication that no such obligation previously existed." 403 F.2d at 164-65 (footnote omitted).

[15] *E.g.*, 1934 Act Rel. No. 15548, [1979] CCH F. Sec. L. Rep. ¶ 81,935 (February 15, 1979); 1934 Act Rel. No. 16384, F. Sec. L. Rep. No. 835 (Dec. 5, 1979 Part II); 1934 Act Rel. No. 16385, *id.*; 1934 Act Rel. No. 9950 (Jan. 16, 1973); and releases cited in text.

presaging adoption of Rule 14e-3, with one isolated exception,[16] even so much as hinted that Rule 10b-5 had any office to perform in the area of noninside, market information. Moreover, as the Chairman of the ABA Subcommittee on Broker-Dealer Matters and his counterpart from the ABA Subcommittee on Rule 10b-5 implicitly recognized when they responded to the request quoted above, Rule 10b-5 could not have been relied on to preempt the field:

> "It would be erroneous, in our view, to assume that the category of 'outside facts' has some pervading immunity from the proscriptions of the anti-fraud rules. On the other hand we are concerned that, in the absence of some official statement by the Commission on this subject, confusion may continue to rise out of somewhat inconsistent positions articulated from time to time by individual members of the Commission's Staff. We believe, therefore, that it would be appropriate for the Commission to establish guide-

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[16] In a release dated February 5, 1979 accompanying proposed Rule 14e-2, the predecessor to Rule 14e-3, the Commission noted that previously, § 10b and Rule 10b-5 had "provided the basis for judicial consideration of the issue of trading by persons in possession of the bidder's non-public intention to make a tender offer." 1934 Act Rel. No. 15548, 44 Fed. Reg. 9956, at 9977 (Feb. 15, 1979). In a footnote, the SEC cited *SEC v. Sorg Printing Co.*, 1974-75 CCH Fed. Sec. L. Rep. ¶ 95,034 (S.D.N.Y. 1975); but as noted *infra* at p. 21, the Court in *Sorg* did not have to reach the issue of liability under Rule 10b-5. 44 Fed. Reg. at 9977 n.115. The SEC continued its discussion of the function of Rule 10b-5 by referring to *Chiarella*, which had recently been decided by the Second Circuit. *Id.* at 9977. The SEC quoted the language of the Second Circuit squarely rejected by the Supreme Court; to wit, that a noninsider was guilty of a Rule 10b-5 violation when he fails to disclose his knowledge of an impending tender offer to the other party to a securities transaction. No mention was made of the theory that a 10b-5 violation could be found in the noninsider's breach of a fiduciary duty to the acquiring corporation.

lines as to disclosure requirements for 'outside facts', and we offer the following comments in that regard.

* * * *

"(b) Moreover, in our view *not every failure to disclose material information constitutes a violation of the anti-fraud rules. There remains the requirement that the non-disclosure either renders some other statement misleading or itself comprises part of an artifice or course of business-operating as a fraud upon the other party in the transaction.*"

ABA Comment Letter on Material, Non-Public Information, dated Oct. 15, 1973, *reprinted in* Sec. Reg. & L. Rep. (No. 233) D-1, at D-6 (Jan. 2, 1974) (emphasis added).

The government urges, however, that judicial precedent evidences a recent trend to find liability under Rule 10b-5 not only on the basis of an insider relationship with a concomitant fraud on the other party to the transaction, but also on the basis of a breach of a fiduciary duty owed to some one other than the purchaser or seller in the securities transaction, the theory presented by the instant indictment. In support of this theory, the Government refers to a series of actions filed over the past decade charging persons with misusing confidential information concerning mergers, acquisitions, and takeovers in violation of Rule 10b-5, including cases which involved trading on information obtained from the acquiring as opposed to the target company. Contrary to the Government's position, however, none of those actions could have apprised Newman that the conduct in which he engaged violated Rule § 10b and Rule 10b-5 on the theory that he breached, or aided and abetted the breach, a fiduciary duty to his co-conspirators' employers and their clients, the acquiring corporations.

The majority of the citations offered by the Government consist of complaints, consent decrees, and a plea to an indictment; the remaining four are to judicial opinions.

The former, unlitigated as they were, are of no precedential value. The cited SEC actions which involved leaks emanating from the acquiring corporation or its agents were, for the most part, instituted after the conspiracy alleged in this indictment were concluded; those that preceded Newman's conduct all spoke of the duty of the traditional insider or of a duty to the seller or purchaser,[17] theories not relied on in this case. Of greater importance, however, "civil consent decrees, entered into by parties who may want to avoid further litigation for any number of reasons, cannot," as Judge Meskill noted, 588 F.2d at 1377 n.6, "transform behavior denounced by the SEC into criminal conduct"; the same principle applies with equal force to the plea. Although the SEC's views of what constitutes unlawful conduct should be given deference, "the 'clear and definite statement of the conduct proscribed' to which . . . a defendant is entitled must emanate from the language of the statute itself, from prior judicial interpretation, or from established custom and usage." *Id.* at 1377.

Turning then to prior judicial interpretations, the four opinions which the Government claims should have put Newman on notice as to the illegality of his conduct are inapposite, as none of them departed from the more tra-

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[17] *SEC v. Golcenda*, [1969-70] CCH F. Sec. L. Rep. ¶ 92,504 (S.D.N.Y. 1969) (inside information obtained by virtue of defendant's position with one of two merging companies); *SEC v. Bradford*, 72 Civ. 4776 (S.D.N.Y. 1972), discussed in *Fridrich v. Bradford*, 542 F.2d 307 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977) (defendants traded in target company's stock on basis of tip from insider of target); *SEC v. Rosenberg*, 1974 CCH F. Sec. L. Rep. ¶ 94,766 (S.D.N.Y. 1974) (complaint charged insider of target company in proposed merger with trading in own company's stock); *SEC v. Avoub*, 1976 CCH F. Sec. L. Rep. ¶ 95, 567 (S.D.N.Y. 1976) (complaint charged *Chiarella* fact pattern, alleging duty to disclose to *sellers* and other members of the public); *SEC v. Prinar Typographers, Inc.*, 1976 CCH F. Sec. L. Rep. ¶ 95,734 (S.D.N.Y. 1976) (complaint charged *Chiarella* fact pattern; although person to whom duty to disclose is not specified, language only supports inference that duty owed to seller).

ditional use to which Rule 10b-5 had previously been put. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970), involved a merger of Westinghouse into American Standard. Before the merger was accomplished, Standard had traded, on the basis of nonpublic information, in Westinghouse stock in order to frustrate plaintiff's own attempt to acquire Westinghouse. Although Standard was obviously a bidder as opposed to a target, that circumstance played no part in the Court's holding that Standard violated Rule 10b-5. Rather, the Court made careful note of Standard's position as an insider in Westinghouse, *id.* at 796, and that plaintiff was a forced seller of the Westinghouse stock with standing to sue. *Id.* at 797-98. *SEC v. Geon Industries, Inc*, 381 F.Supp. 1063 (S.D.N.Y. 1974), *aff'd in part*, 531 F.2d 39 (2d Cir. 1976), and *SEC v. Shapiro*, 349 F.Supp. 46 (S.D.N.Y. 1972), *aff'd*, 494 F.2d 1301 (2d Cir. 1974), also involved the traditional duty to disclose premised on the defendant's position as an insider, or a tippee of an insider, in the corporation in whose securities he traded. Finally, in *SEC v. Sorg Printing Co.*, 1974-75 CCH Fed. Sec. L. Rep. ¶ 95,034, at p. 97,612 (S.D.N.Y. 1975), which involved facts substantially similar to those in *Chiarella*, three of the four defendants consented to entry of a preliminary injunction; with respect to the fourth, the Court did not have to reach the issue of liability under Rule 10b-5.

Nor do the cases that have treated "misappropriation" as fraud within the meaning of Rule 10b-5 lend any support to the Government. *See, e.g., Superintendent of Insurance v. Bankers Trust*, 404 U.S. 6 (1971); *United States v. Brown*, 555 F.2d 336, 339 (2d Cir. 1977); *A.T. Brod & Co. v. Perlow*, 375 F.2d 393 (2d Cir. 1967); *Alico Nat. Corp. v. Amalgamated Meat Cutters & Butcher Workmen*, 397 F.2d 727 (7th Cir. 1968). Those cases all concerned schemes which "were clearly fraudulent under any definition of the term fraud," *Chiarella* (2d Cir.), *supra*, 588 F.2d at 1375 n.3 (Meskill, J., dissenting); they

involved misappropriation of either the securities themselves or the proceeds of the sale, resulting in the direct deprivation of a party to the transaction (seller, broker, or owner of securities). In contrast, the scheme perpetrated by Newman and his co-conspirators succeeded from the misappropriation of information. While the acquiring corporations and investment bankers were damaged as a result insofar as they were deprived of their agents' duty of loyalty and ethical behavior, they were not damaged in their role as future investors in the target companies. While the injury of the latter type falls generally within the domain of federal law, the former category is more appropriately governed by state law. *See O'Brien v. Continental Illinois Nat'l Bank & Trust Co.*, 593 F.2d 54, 61, 63 (7th Cir. 1979), *citing Santa Fe Industries, Inc. v. Green, supra*, 430 U.S. at 478.

In light of this analysis, I conclude that there was no "clear and definite statement" in the federal securities laws which both antedated and proscribed the acts alleged in this indictment. As of the times alleged, neither courts, commentators, nor the SEC in its rule-making or enforcement capacities had stated that Rule 10b-5 extended to a noninsider's breach of a fiduciary duty owed to the acquiring corporation in a tender offer. To the extent the question was addressed at all, the indications, as we have seen, were quite to the contrary. While the SEC has concerned itself with the general subject of tender offers at least since enactment of the Williams Act in 1968, the conduct sought here to be prosecuted was not proscribed until 1980, when Rule 14e-3 was promulgated. Prior to that time, the absence of such a rule, particularly when viewed in the context of the SEC's inquiry to the industry as to whether one should be adopted, precludes criminal prosecutions for what is, in effect, unproscribed conduct.[18]

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[18] *Cf. Chiarella* at 445 U.S. at 233-34:

"As we have seen, no such evidence emerges from the language or legislative history of § 10(b). Moreover, neither the Con-

As noted *supra* at n.10, on two occasions one or the other of the investment banking firms acted on behalf of the target company. The Government noted that fact in its brief; neither party considers its legal significance, if any. I conclude that it has none. Any theory that, in such circumstances, these defendants are in fact insiders or their tippees, and consequently defrauded sellers of the target company's securities along classic 10(b) lines, may not be based upon this indictment, which proceeds upon a quite different theory. While the indictment does charge that defendants committed fraud upon, *inter alia*, the investment banks' corporate clients (including, in these instances, target companies), it is not a fraud perpetrated upon the companies as purchasers or sellers of securities, a requisite element under the securities laws. *Chiarella*, *supra*, at 230; *SEC v. Texas Gulf Sulphur Co.*, *supra*, at 860; *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 463 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). *Cf. Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971) (fraudulent concealments of corporate insiders implicated § 10(b) where as a result the corporation "suffered an injury as a result of deceptive practices touching its sale of securities as an investor").

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gress nor the Commission ever has adopted a parity-of-information rule. Instead the problems caused by misuse of market information have been addressed by detailed and sophisticated regulation that recognizes when use of market information may not harm operation of the securities markets. For example, the Williams Act limits but does not completely prohibit a tender offeror's purchases of target corporation stock before public announcement of the offer. Congress' careful action in this and other areas contrasts, and is in some tension, with the broad rule of liability we are asked to adopt in this case."

This analysis is equally applicable to the alternative rule of liability the Government now asks this Court to adopt.

I hold that the indictment does not charge Newman with acts that were proscribed by the securities laws then in force. The § 10b counts must be dismissed.

IV.

Counts 2 through 14 of the indictment allege violation of the mail fraud statute, 18 U.S.C. § 1341.[19] The preamble to the mail fraud counts, ¶ 12 of the indictment, recapitulates the scheme charged in the conspiracy count; ¶ 13 charges that defendants caused the specified mailings "for the purpose of executing said scheme and artifice and attempting to do so . . ."

Thus it is apparent that the same conduct forms the subject of all counts in the indictment: conspiracy, substantive securities violations, and mail fraud. The case is comparable in that regard to *United States v. Henderson*, 386 F.Supp. 1048, 1052 (S.D.N.Y. 1974), where Judge Weinfeld observed: "The only difference is the addition of the mails to effectuate the alleged scheme to defraud."

Newman argues from *Henderson* that the mail fraud counts should be dismissed because a general anti-fraud statute has no legitimate office to perform in an area covered by a comprehensive regulatory scheme. The prosecution in *Henderson* was for evasion of income taxes. Judge Weinfeld, dismissing the mail fraud counts, accepted defendant's contention "that the mail fraud statute was not intended by Congress to apply to a scheme to defraud the United States in an attempt to evade the payment of taxes, which is the scheme charged in counts 1-3." 386

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[19] Although the substantive counts of the indictment charge only violation of the mail fraud statute, Count 1 of the indictment alleges conspiracy to violate the wire fraud statute, 18 U.S.C. § 1343, as well. The term "scheme or artifice to defraud," which appears in both statutes, has been treated uniformly by the courts in applying both the mail and wire fraud statutes. *United States v. Barta*, 635 F.2d 999, 1005 n.11 (2d Cir. 1980). The following discussion, therefore, would be equally applicable to the wire fraud statute.

F.Supp. at 1052. Neither court nor counsel in *Henderson* could find "a single instance of such a prosecution," *ibid.* Judge Weinfeld said of the mail fraud statute:

> "As Mr. Chief Justice Burger recently observed, the mail fraud statute 'has traditionally been used against fraudulent activity as a first line of defense. When a "new" fraud develops—as constantly happens—the mail fraud statute becomes a stop-gap device to deal on a temporary basis with the new phenomenon, until particularized legislation can be developed and passed to deal directly with the evil.' The mail fraud provision encompasses schemes to defraud the 'guileless members of the public with worthless securities, patent medicines, deeds to arid lands and inaccessible tracts of land, or other empty promises of instant wealth and happiness.'
>
> "The sweep of the statute is broad indeed, but the entire course of the statute's application has been to schemes of a different nature from the scheme alleged in this indictment. The use of the mail fraud provision has been generally confined to schemes of a type designed to defraud members of the community at large, in the sale of commodities and services, rather than schemes to defraud the government, as is involved in this case. The court is of the view that the statute does not include within its proscription a scheme to defraud the Internal Revenue Service in the collection of income taxes. There is in such a case no need to use the mail fraud statute as a 'stopgap device' until 'particularized legislation' is enacted 'to deal directly with the evil,' for Congress has enacted legislation that affords adequate protection of the public interest in the collection of income taxes." *Id.* at 1053 (footnotes omitted).

There is considerable force to Newman's argument. The conduct described in the indictment did not constitute a "new" fraud in any way; such conduct had en-

gaged the attention and concern of the SEC and Congress for a number of years. Furthermore, Congress by statute and the SEC by regulations had enacted "particularized legislation . . . to deal directly with the evil." As we have seen under Point III, *supra*, at the time embraced by the indictment the SEC had refrained from proscribing this course of conduct as fraudulent within the securities laws. Thus it is arguable that a general statute, such as the mail fraud statute, may not be used by the Government to proscribe conduct which was under consideration, but not yet proscribed, by the particular agency charged with responsibility in the specific area.

However, Judge Weinfeld dealt in *Henderson* with the coupling of mail fraud counts to a tax evasion scheme, and stressed that he could find no precedent for such a prosecution, going on to observe that use of the mail fraud statute "has been generally confined to schemes of a type designed to defraud members of the community at large, in the sale of commodities and services, rather than schemes to defraud the Government," *id.* at 1053. The case at bar falls within the former general category; and in *United States v. Dixon*, 536 F.2d 1388, 1399 (2d Cir. 1976), the Second Circuit accepted the Government's observation that "mail fraud and securities law violations are frequently joined in a single indictment," going on to cite illustrative cases.

In these circumstances, I decline to follow *Henderson* and dismiss the mail fraud counts simply because they arise out of the same course of conduct as the securities fraud counts. But that does not end the matter. It remains to consider whether the requisite elements of mail fraud, as explicated by controlling authority, are alleged in the indictment. *Cf. United States v. Reed*, 639 F.2d 896, 904 (2d Cir. 1981).

The question is whether the conduct alleged in the indictment constitutes a "scheme to defraud" or "obtaining

money by false pretenses" within the prohibition of 18 U.S.C. § 1341. That question may be answered in the negative, although in the Court's view the conduct alleged is "repugnant to standards of business morality." *United States v. Regent Office Supply Co.*, 421 F.2d 1174, 1179 (2d Cir. 1970). The decisive issue is not the morality of the conduct, but whether it is punishable under the statute; and the words of the mail fraud statute are not to be stretched beyond their normal bounds. That is because "ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity," *Rewis v. United States*, 401 U.S. 808, 812 (1971), quoted and applied in *United States v. Dixon*, *supra*, 536 F.2d at 1401.

The mail fraud statute, as construed by the Second Circuit, requires the Government to prove "that some actual harm or injury was *contemplated* by the schemer." *United States v. Regent Office Supply Co.*, *supra*, 421 F.2d at 1180 (emphasis in original). That is because the Second Circuit has expressly declined, "in the area of private decision making," to follow Judge Learned Hand's dictum in *United States v. Rowe*, 56 F.2d 747, 749 (2d Cir.), *cert. denied*, 286 U.S. 554 (1932), that "false representations, in the context of a commercial transaction, are per se fraudulent despite the absence of any proof of actual injury to any customer." *Dixon*, *supra*, 536 F.2d at 1400; *Regent Office Supply*, *supra*, 421 F.2d at 1179-82. While, as *Regent Office Supply* acknowledges, a "scheme to defraud' does not require proof that "purchasers were in fact defrauded," proof of the schemer's *contemplation* of some actual harm or injury to his victim remains essential.

Thus in *Regent Office Supply* the Second Circuit held that false representations made by stationery salesmen in telephone conversations with potential customers did not violate the mail fraud statute,[20] where what was said did

[20] The mail fraud statute was implicated by the subsequent mailing of invoices.

not misrepresent in any way the quality of the merchandise or its price. The court rejected the Government's theory "that fraud may exist in a commercial transaction even when the customer gets exactly what he expected and at the price he expected to pay." 421 F.2d at 1180. The conduct did not fall within the statute, Judge Moore wrote for the Second Circuit, because:

> "Although proof that the injury was accomplished is not required to convict under 1341, we believe the statute does require evidence from which it may be inferred that some actual injury to the victim, however slight, is a reasonably probable result of the deceitful representations if they are successful." *Id.* at 1182.

In *Dixon*, a corporate officer failed to disclose in proxy statements the making of loans which he should have revealed, the officer thereafter being elected president of the corporation. The Government indicted the defendant for conspiracy and substantive violations of the securities laws in respect of proxies; it also included counts under the mail fraud statute, the improperly solicited proxies having been returned by stockholders through the mails. The Second Circuit affirmed the convictions on the conspiracy and securities law counts, but dismissed the mail fraud counts. Judge Friendly's opinion recognizes that "[t]here is abundant authority that a scheme to use a private fiduciary position to obtain direct pecuniary gain is within the mail fraud statute," so that "the use of a deficient proxy statement to obtain approval of a transaction violating fiduciary duty, e.g., the sale of corporate property to a director at what was known to be less than its fair value, would be a violation of the mail fraud statute." 536 F.2d at 1399-1400. That is so, of course, because in that hypothetical case the faithless director achieves his pecuniary gain at the direct expense of his defrauded company. The *Dixon* court specifically reiterated the requirement expressed in *Regent Office Supply*

that the Government must prove "that some actual harm or injury [to the victim of the fraud] was *contemplated.*" *Id.* at 1399 n.11. But all that appeared in *Dixon* was the corporate officer's nondisclosure of transactions that he should have revealed; and, the court held: "This effort to avoid disclosure, although a breach of a statutory obligation, was hardly 'a scheme or artifice to defraud' in the sense of the mail fraud statute in the context of this case." *Id.* at 1400.

The *Dixon* court declined to accept the Government's argument that the defendant's nondisclosure in the proxy statement deprived the stockholders of his "honest and faithful services," so as to constitute a violation of the mail fraud statute. Rejecting that theory, the Second Circuit stated:

> "This doctrine of the deprivation of honest and faithful services has developed to fit the situation in which a public official avails himself of his public position to enhance his private advantage, often by taking bribes. Such actions may not deplete the fisc; indeed, as in *Isaacs*, they may have enriched it, but they are nonetheless frauds since the public official has been paid to act in breach of his duties. Thus the doctrine has been applied to the corruption of a public official with respect to the allocation of insurance commissions although these must, in any case, have been paid by the state to someone . . . [citing cases]. See also the cases under the portion of the general conspiracy statute, 18 U.S.C. § 371, which makes it a crime to conspire 'to defraud the United States, or any agency thereof in any matter or for any purpose. . .' [citing cases]. All these cases, however, involved an element of corruption not present here. We therefore need not consider whether the doctrine of the cited cases should be carried over into the private field, e.g., if, for example, Dixon had bribed En-

twisle to put out a proxy statement known to be incomplete." *Id.* at 1401.[21]

The most recent Second Circuit authority is *United States v. Barta*, 635 F.2d 999 (2d Cir. 1980), upon which both the Government and Newman rely. Comprehension of the opinion is assisted by particular attention to the underlying facts. The defendant, one John Von Barta, was employed as a salesman and trader of Government bonds at Malon S. Andrus, Inc. ("Andrus"), a small securities firm. Von Barta enjoyed a powerful and trusted position at Andrus, having considerable discretion to open new customer accounts. He had been particularly admonished never to jeopardize the firm's banking relationships and always to advise the senior partner if the firm's repurchase agreements, arising out of the trading in Government bonds "were in trouble." 635 F.2d at 1002. Von Barta disregarded this instruction, and betrayed his trust, by joining with another individual in forming the Piwacket Corp. ("Piwacket"), which Von Barta and his co-schemer used as a vehicle for trading in Government bonds. That co-schemer, one Harty, held a comparable position of trust at the larger brokerage firm of Blyth Eastman Dillon & Co. ("Blyth"). Piwacket became one of Andrus's most active accounts, ultimately speculating in Government bonds worth more than $50 million, and incurring liabilities "vastly in excess of the combined ability of Andrus and Piwacket to secure Piwacket's creditors against loss." *Id.* at 1003. When the volume of Piwacket's trading attracted the attention of Andrus's senior partner, Von Barta falsely told him that Piwacket was an established Long Island arbitrageur.

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[21] The "Entwisle" referred to in the opinion was the corporation's general counsel at the pertinent times. In the case at bar, there is no allegation that any defendant bribed anyone else; the charge is one of deprivation of honest and faithful service *simpliciter*. *Dixon*, following *Regent Office Supply*, clearly rejects that theory in the private field.

The fraud was exposed when, as the Second Circuit narrated at 1003:

> "At first, Piwacket's trades were very successful, generating profits of nearly $200,000. Later, however the bond market weakened. When Von Barta indicated that Piwacket could not cover its losses, Andrus terminated the Piwacket account. Piwacket's resultant insolvency forced Andrus and Blyth to bear a $2 million loss."

Against this factual background, the Government indicted Von Barta for violating the mail and wire fraud statutes, the latter being found at 18 U.S.C. § 1343. The indictment charged Von Barta and his co-schemers with fraudulent inducement of Andrus and other firms to permit defendant and his cohorts:

> ". . . to speculate without substantial risk in government bonds worth in excess of $50,000,000 in such a way that the profits of such speculation would largely be realized by Von Barta and his co-schemers while the losses from such speculation would largely be borne by Andrus, Blyth, and the other firms."

The indictment further alleged:

> "As a result of the scheme and artifice to defraud, Andrus, Blyth and the other firms suffered losses of nearly $2,000,000."

In pre-trial motion practice before District Judge Brieant, the Government expressed the view that breach of an employee's fiduciary duty, without tangible, pecuniary harm to the employer, would constitute mail fraud. Judge Brieant declined to "extend the wide mouthed purse seine of 'mail fraud' to include mere breaches of a fiduciary duty of honesty and loyalty by an employee, coupled with material misstatements of fact or non-disclosure." Appendix for the United States on appeal, A.74. Judge Brieant went on to say that "[i]n the alternative, the gov-

ernment could assert that it will prove that defendant contemplated actual pecuniary injury to Andrus, Blyth and others, as well as pecuniary benefits to himself, when he failed to disclose material information and made material misstatements," adding his view that this alternative theory "would be the only one available" to the Government under the mail fraud statute. *Id.* at A.102-104. Upon the Government's response that it would rely only on "intangible" harm, Judge Brieant dismissed the indictment. And thus the case found its way to the Court of Appeals.

The task the Second Circuit set itself, as I construe Judge Kaufman's opinion, was to decide whether the conduct alleged in the indictment was prohibited by the mail fraud statute. That this was the issue addressed by the Court appears clearly enough from the opinion's penultimate sentence:

> "We simply hold that on the facts alleged by the Government, Von Barta's breach of his duty of disclosure subjects him to prosecution for mail fraud." 635 F.2d at 1007.

Reviewing the elements necessary to make out a mail fraud violation the *Barta* court, in an extensive footnote beginning at 1005 n.14, reiterated the rule of *Regent Office Supply* and *Dixon*:

> "And although the Government need not show that the scheme's victims were in fact defrauded, *United States v. Andreadis*, 366 F.2d 423, 431 (2d Cir. 1966), *cert. denied*, 385 U.S. 1001, 87 S.Ct. 703, 17 L.Ed.2d 541 (1967), the prosecution must prove that some actual harm or injury was at least contemplated, *United States v. Dixon*, 536 F.2d 1388, 1399 n.11 (2d Cir. 1976); *United States v. Regent Office Supply Co., supra*, 421 F.2d at 1180."

That element was satisfied by the facts specifically alleged in the indictment, which the court summarized again in 1007:

> "Von Barta was admonished to warn Mr. Andrus if the firm's repurchase agreements 'were in trouble.' But he said nothing upon opening an account for an allegedly undercapitalized firm, knowing, as an experienced trader for Andrus, that if Piwacket became insolvent, Andrus would be liable for any losses. Nor can we overlook the fact that by trading in millions of dollars, Von Barta exposed Andrus to liabilities greatly in excess of Andrus's limited ability to meet them. When Mr. Andrus became concerned, however, and inquired about Piwacket, Von Barta dissimulated, telling his employer that Piwacket was backed by credit worthy arbitrageurs from Long Island. Von Barta's alleged scheme to speculate in the bond market using Andrus's credit was eminently successful. At first, Von Barta pocketed nearly $100,000 from Piwacket's trades, but when the market collapsed, Andrus was left with nothing but a responsibility for heavy debts."

Thus a grave economic loss to Andrus, a possibility clearly "contemplated" by defendant as "an experienced trader," actually came to pass.

This analysis of the facts places in context and clarifies the discussion with which Judge Kaufman begins the opinion in *Barta*:

> "In the instant case, we are asked to construe two seemingly limitless provisions, the mail and wire fraud statutes, in the context of the employer-employee relationship. The Government urges us to hold that these statutes are violated whenever an employee, acting to further a scheme for pecuniary gain, intentionally breaches a fiduciary duty of honesty or loyalty he owes his employer. The defendant decries this 'over-criminalization' of the employment relationship, and asks us to declare his alleged conduct exempt from criminal sanction. While we reject

> the sweeping theory advanced by the Government, we find that the mail and wire fraud statutes do reach the conduct with which the defendant is charged." *Id.* at 1001-02 (footnotes omitted).

This introduction dwells in perfect harmony with the balance of the opinion. The defendant was subject to prosecution under the mail fraud statute for "the conduct with which [he] is charged"; but the Second Circuit rejected that "sweeping theory advanced by the Government," that the mail fraud statute is violated "whenever an employee, acting to further a scheme for pecuniary gain, intentionally breaches a fiduciary duty of honesty or loyalty he owes to his employer."

The present mail fraud counts fail because they have no visible means of support other than the "sweeping theory" rejected by the Second Circuit in *Barta*. Unlike the indictment in *Barta*, the present indictment is devoid of any allegation of economic loss, actual or contemplated, on the part of the investment banks or their clients. In ¶ 10(d) of the indictment, the Government describes the essence of defendants' conduct:

> "In so doing, and by sharing profits from the sale of those securities with Courtois and Antoniu, Newman, Carniol and Spyropoulos aided, participated in and facilitated Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn Loeb, and clients of those investment bankers."

That allegation precisely parallels the theory rejected in *Barta*, namely, that the mail and wire fraud statutes "are violated whenever an employee, acting to further a scheme for pecuniary gain, intentionally breaches a fiduciary duty of honesty or loyalty he owes to his employer." In the private field, as opposed to the acts of faithless public servants, that theory, if unaccompanied by allegations or proof of direct, tangible, economic loss to the

victim, actual or contemplated, is insufficient in law under controlling authority in this circuit.[22] The conduct alleged in the indictment cannot be brought within the mail fraud statute without stretching its terms beyond the degree permitted by basic principles of criminal law. Accordingly, the mail fraud counts must also be dismissed.

V.

The substantive counts having been dismissed for legal insufficiency, it necessarily follows that the conspiracy count must also be dismissed. A conspiracy count will not lie under 18 U.S.C. § 371 if the actions forming the subject matter of the conspiracy do not themselves constitute substantive crimes. *United States v. Galardi*, 476 F.2d 1072, 1079 (9th Cir.), *cert. denied*, 414 U.S. 839 (1973).

VI.

If the allegations of this indictment are true, Newman and the other defendants engaged in dishonorable and despicable conduct. That they may not be prosecuted under these federal criminal statutes may appear, at first blush, as a failure of the legal system. But in truth, the case illustrates the sound working of that system. Government may not place a citizen in jeopardy of his freedom unless Government can say that the law clearly and unequivocally prohibited the citizen's acts at the time of his actions.

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[22] The Government's theorizing as to the economic harm that defendants' conduct might cause bidding companies in takeovers, or the harm that might be reflected in a loss of "business-getting ability of Morgan Stanley and Kuhn Loeb" (brief at 37), does not rise to the level of that "*actual* harm or injury" which the mail fraud perpetrator must at least "contemplate." "Contemplate," in this context, means "to have in view as contingent or probable as an end or intention." Black's Law Dictionary (4th ed., 1951) at 389. The Government's speculations in the case at bar stretch that concept too far.

Lawyers say that to do otherwise constitutes a deprivation of due process. Laymen, with their preference for simpler words, say: it is not fair. Upon such principles of fairness, at once elemental and profound, our liberties depend; and while at times the law implements those principles for the benefit of disreputable people, that is a necessary consequence of the law's concern for all citizens.

For the foregoing reasons, the Court has previously entered its order dismissing the indictment as to defendant Newman.[23]

Dated: New York, New York
June 5, 1981

/s/ Charles S. Haight, Jr.
CHARLES S. HAIGHT, JR.
U.S.D.J.

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[23] The indictment is dismissed as to Newman only because the other defendants have absented themselves from the Court's jurisdiction, have not been arraigned, and have not appeared by counsel. Any application for relief based upon this decision must be preceded by arraignment and appearance.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 1728, Docket 81-1225

UNITED STATES OF AMERICA,
Appellant,

v.

JAMES MITCHELL NEWMAN,
Defendant-Appellee.

Argued July 17, 1981

Decided Oct. 30, 1981

John S. Martin, Jr., New York City, U.S. Atty., S.D.N.Y. (Lee S. Richards and Mark F. Pomerantz, Asst. U.S. Attys., New York City, of counsel), for appellant.

Franklin B. Velie, New York City (Gordon Hurwitz, Butowsky, Baker, Weitzen, Shalov & Needell, David M. Butowsky, Theodore Altman, Paul D. Wexler, New York City, and Kenneth S. Gerstein, of counsel), for defendant-appellee.

Paul Gonson, Sol. S.E.C., Washington, D.C. (Michael K. Wolensky, Associate Gen. Counsel, Donald C. Langevoort, Sp. Counsel, Richard M. Starr, Washington, D.C., of counsel), for S.E.C. as amicus curiae.

Before VAN GRAAFEILAND and NEWMAN, Circuit Judges, and DUMBAULD,* District Judge.

VAN GRAAFEILAND, Circuit Judge:

The United States appeals from an order of the United States District Court for the Southern District of New

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* Of the Western District of Pennsylvania, sitting by designation.

York which dismissed an indictment charging James Mitchell Newman with securities fraud, section 10(b) of the Securities and Exchange Act of 1934 (15 U.S.C. § 78j (b)) and Rule 10b-5 (17 C.F.R. § 240.10b-5), mail fraud, 18 U.S.C. § 1341, and conspiracy to commit securities and mail fraud, 18 U.S.C. § 371. The district court dismissed the securities fraud charge because it concluded that "there was no 'clear and definite statement' in the federal securities laws which both antedated and proscribed the acts alleged in [the] indictment" so as to give the defendant a reasonable opportunity to know that his conduct was prohibited. The district court held that the allegations of mail fraud failed as a matter of law to charge a crime. The conspiracy count, the district court said, fell with the two substantive counts. We reverse.

Although the indictment names appellee Newman and E. Jacques Courtois, Jr., Franklin Carniol, and Constantine Spyropoulos as defendants, only Newman was within the jurisdiction of the district court and a party to the proceedings below. The allegations of the indictment refer to all defendants, however, and, for purposes of this opinion, we assume the following summary of facts to be true. *See United States v. Von Barta*, 635 F.2d 999, 1002 (2d Cir. 1980), *cert. denied*, 450 U.S. 998, 101 S.Ct. 1703, 68 L.Ed.2d 199 (1981).

Morgan Stanley & Co. Inc. and Kuhn Loeb & Co., now known as Lehman Brothers Kuhn Leob Inc., are investment banking firms which present companies engaged in corporate mergers, acquisitions, tender offers, and other takeovers. From 1972 to 1975, Courtois and an alleged but unindicted co-conspirator, Adrian Antoniu, were employed by Morgan Stanley and went to work with Kuhn Loeb. Between January 1, 1973 and December 31, 1978, Courtois and Antoniu misappropriated confidential information concerning proposed mergers and acquisitions that was entrusted to their employers by corporate clients. This information was conveyed surreptitiously to New-

man, a securities trader and manager of the over-the-counter trading department of a New York brokerage firm. Newman passed along the information to two confederates, Carniol, a resident of Belgium, and Spyropoulos, a Greek citizen who lived in both Greece and France. Using secret foreign bank and trust accounts and spreading their purchases among brokers, all for the purpose of avoiding detection, the three conspirators purchased stock in companies that were merger and takeover targets of clients of Morgan Stanley and Kuhn Loeb.[1] They then reaped substantial gains when the mergers or takeovers were announced and the market price of the stocks rose. These profits were shared with Courtois and Antoniu, the sources of the wrongfully-acquired information.

We believe that these allegations of wrongdoing were sufficient to withstand challenge in all three counts.

THE SECURITIES FRAUD

In preparing the indictment, the Government attempted to remedy a deficiency that led to the Supreme Court's reversal of a conviction in *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980). In that case, the defendant secured confidential information concerning proposed corporate takeovers through his position as a mark-up man in a financial printing establishment doing work for companies planning takeovers. He, too, prospered by purchasing stock in target companies. His conviction for section 10(b) and Rule 10b-5

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[1] In two instances the targets themselves were clients of the investment banking firms. The Government belatedly suggests that the indictment should be construed to allege securities laws violations in these two instances, on the theory that the defendants, by purchasing stock in the target companies, defrauded the shareholders of those companies. Whatever validity that approach might have, it is not fairly within the allegations of the indictment, which allege essentially that the defendants defrauded the investment banking firms and the firms' takeover clients.

violations was affirmed by this Court, *United States v. Chiarella*, 588 F.2d 1358 (2d Cir. 1978) but reversed by the Supreme Court because that Court found no fiduciary relationship between Chiarella and the sellers of stock which imposed upon him a duty to speak. 445 U.S. at 231-35, 100 S.Ct. at 1116-18.

The thrust of the Government's case in *Chiarella* was that the defendant violated section 10(b) and Rule 10b-5 by failing to disclose material, non-public information to the shareholders of target companies from whom he purchased stock. *Id.* at 236, 100 S.Ct. at 1119. As the Court observed, "[t]he jury was not instructed on the nature or elements of a duty owed by petitioner to anyone other than the sellers." *Id.* To remedy the deficiency in *Chiarella*, the Government here has pointed its charge of wrongdoing in a different direction. The indictment charges that Courtois and Antoniu breached the trust and confidence placed in them and their employers by the employers' corporate clients and the clients' shareholders, and the trust and confidence placed in Courtois and Antoniu by their employers. The indictment charges further that Newman, Carniol, and Spyropoulos "aided, participated in and facilitated Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn Loeb, and clients of those investment banks." The indictment also charges that Courtois, Newman, and Carniol "did directly and indirectly, (a) employ devices, schemes, and artifices to defraud and (b) engage in acts, practices, and courses of business which operated as a fraud and deceit on Morgan Stanley, Kuhn Loeb, and those corporations and shareholders on whose behalf Morgan Stanley or Kuhn Loeb was acting, and to whom Morgan Stanley or Kuhn Loeb owed fiduciary duties, in connection with the purchase of securities . . . ."

Then Chief Judge Kaufman, writing for this Court in *Chiarella, supra*, stated that violation of an agent's duty

to respect client confidences was a clear transgression of Rule 10b-5 "where, as here, the converted information both concerned securities and was used to purchase and sell securities." 588 F.2d at 1368 n.14.[2] The Supreme Court majority found it unnecessary to decide whether this theory had merit, because it was not presented to the jury. 445 U.S. at 236-37, 100 S.Ct. at 1119-20. Justice Stevens stated in his concurring opinion that a legitimate argument could be made that Chiarella's conduct constituted a fraud or deceit upon his employer's clients but that it could also be argued that there was no actionable violation of Rule 10b-5 because the clients were neither purchasers nor sellers of target company securities. *Id.* at 238, 100 S.Ct. at 1120. He added that the Court "wisely leaves the resolution of this issue for another day." For this Court, that day has now come.

We hold that appellee's conduct as alleged in the indictment could be found to constitute a criminal violation of section 10(b) and Rule 10b-5[3] despite the fact that neither Morgan Stanley, Kuhn Loeb nor their clients was at the time a purchaser or seller of the target company securities in any transaction with any of the defendants.

Because enforcement of section 10(b) and Rule 10b-5 has been largely by means of civil litigation, *United States v. Chiarella*, *supra*, 588 F.2d at 1378 (Meskill, *J.* dissenting) (citing 3 *Bromberg Securities Law* § 10.3 at 241), it is easy to forget that section 10(b) was written as both a regulatory and criminal piece of legislation. *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 396 (2d Cir.

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[2] Although Judge Meskill dissented in *United States v. Chiarella*, his dissent seems to be based primarily upon the absence of a special relationship between Chiarella and the sellers of the stock, the point which the Supreme Court held to be determinative. *See* 588 F.2d at 1378.

[3] The acts covered by the indictment occurred prior to promulgation of Rule 14a-3, dealing specifically with insider trading in connection with tender offers. 17 C.F.R. § 240.14e-3.

1967). Looking at the language of the statute, the "starting point in every case involving construction," *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756, 95 S.Ct. 1917, 1935, 44 L.Ed.2d 539 (1975) (Powell, *J.* concurring), we find no express provision for a private civil remedy. *Id.* at 729, 95 S.Ct. at 1922; *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 24, 97 S.Ct. 926, 940, 51 L.Ed.2d 124 (1977). Section 21 of the Securities and Exchange Act of 1934, 15 U.S.C. § 78u, gives the SEC broad investigatory powers and access to the district court for injunctive and mandamus help in preventing illegal practices. Section 32, 15 U.S.C. § 78ff, provides criminal penalties for willful violation of the Act or rules thereunder, violation of which is made unlawful or the observance of which is required under the Act. There is nothing in the history of the Act to indicate that Congress intended any remedies other than these. *Blue Chip Stamps v. Manor Drug Stores, supra*, 421 U.S. at 729, 95 S.Ct. at 1922.

Rule 10b-5 makes it unlawful for any person to engage in any act or practice which operates as a fraud or deceit upon any person "in connection with the purchase or sale of any security." When litigation under this Rule is instituted by the SEC under section 21 or by a United States Attorney under section 32, the court's concern must be with the scope of the Rule, not plaintiff's standing to sue. *See SEC v. National Securities, Inc.*, 393 U.S. 453, 467 n.9, 89 S.Ct. 564, 572, n.9, 21 L.Ed.2d 668 (1969); *United States v. Naftalin*, 441 U.S. 768, 774 n.6, 99 S.Ct. 2077, 2082 n.6, 60 L.Ed.2d 624 (1979). It is only because the judiciary has created a private cause of action for damages the "contours" of which are not described in the statute, that standing in such cases has become a pivotal issue. *Blue Chip Stamps v. Manor Drug Stores, supra*, 421 U.S. at 737, 749, 95 S.Ct. at 1926, 1931. The courts, not the Congress, have limited Rule 10b-5 suits for damages to the purchasers and sellers of

securities. The district court's statement that fraud perpetrated upon purchasers or sellers of securities is a "requisite element under the securities laws" is, therefore, an overbroad and incorrect summary of the law.

Long before appellee undertook to participate in the fraudulent scheme alleged in the indictment, this Court, and other Courts of Appeals as well, had held that a plaintiff need not be a defrauded purchaser or seller in order to sue for injunctive relief under Rule 10b-5. *See Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 798 (2d Cir. 1969); *Mutual Shares Corp. v. Genesco Inc.*, 384 F.2d 540, 546-47 (2d Cir. 1967); *Kahan v. Rosenstiel*, 424 F.2d 161, 173 (3d Cir.), *cert. denied*, 398 U.S. 950, 90 S.Ct. 1870, 26 L.Ed.2d 290 (1970); *Britt v. Cyril Bath Co.*, 417 F.2d 433, 436 (6th Cir. 1969). These holdings were consistent with the language of Rule 10b-5, which contains no specific requirement that fraud be perpetrated upon the seller or buyer of securities. Appellee reasonably should have anticipated that in a criminal action the courts likewise would follow the language of the Rule.

In determining whether the indictment in the instant case charges a violation of Rule 10b-5, we need spend little time on the issue of fraud and deceit. The wrongdoing charged against appellee and his cohorts was not simply internal corporate mismanagement. *See Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12, 92 S.Ct. 165, 168, 30 L.Ed.2d 128 (1971). In *United States v. Chiarella*, *supra*, 445 U.S. at 245, 100 S.Ct. at 1123, Chief Justice Burger, in dissenting, said that the defendant "misappropriated—stole to put it bluntly—valuable nonpublic information entrusted to him in the utmost confidence." See also, the dissenting opinion of Justice Blackmun in which Justice Marshall concurred. *Id.* at 245-46, 100 S.Ct. at 1123-24. That characterization aptly describes the conduct of the connivers in the instant case.

Had appellant used similar deceptive practices to mulct Morgan Stanley and Kuhn Loeb of cash or securities, it could hardly be argued that those companies had not been defrauded. *See Superintendent of Insurance v. Bankers Life & Casualty Co., supra*, 404 U.S. at 10-11, 92 S.Ct. at 166-167; *United States v. Brown*, 555 F.2d 336, 338-40 (2d Cir. 1977); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979); *Cooper v. North Jersey Trust Co.*, 226 F.Supp. 972, 977-79 (S.D.N.Y. 1964). By sullying the reputations of Courtois' and Antoniu's employers as safe repositories of client confidences, appellee and his cohorts defrauded those employers as surely as if they took their money. *See SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971) (citing *Diamond v. Oreamuno*, 24 N.Y.2d 494, 499, 301 N.Y.S.2d 78, 248 N.E.2d 910 (1969)).

Appellee and cohorts also wronged Morgan Stanley's and Kuhn Loeb's clients, whose takeover plans were keyed to target company stock prices fixed by market forces, not artificially inflated through purchases by purloiners of confidential information.

> In a tender-offer situation, the effect of increased activity in purchases of the target company's shares is, similarly, to drive up the price of the target company's shares; but this effect is damaging to the offering company because the tender offer will appear commensurately less attractive and the activity may cause it to abort.

13A B. Fox & E. Fox, *Business Organizations, Corporate Acquisitions and Mergers*, § 27.05[4] (1981).

In other areas of the law, deceitful misappropriation of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, had consistently been held to be unlawful. *See, e.g., United States v. Girard*, 601 F.2d 69 (2d Cir.), *cert. denied*, 444 U.S. 871, 100 S.Ct. 148, 62 L.Ed.2d 96 (1979); *United States v. Kent*, 608 F.2d 542, 544-45 (5th Cir. 1979), *cert. denied*,

446 U.S. 936, 100 S.Ct. 2153, 64 L.Ed.2d 788 (1980); *Abbott v. United States*, 239 F.2d 310, 313-14 (5th Cir. 1956); *United States v. Buckner*, 108 F.2d 921, 926-27 (2d Cir.), *cert. denied*, 309 U.S. 669, 60 S.Ct. 613, 84 L.Ed. 1016 (1940). Appellee would have had to be most ingenuous to believe that Congress intended to establish a less rigorous code of conduct under the Securities Acts. *See United States v. Naftalin*, *supra*, 441 U.S. at 774-77, 99 S.Ct. at 2082-83; *Superintendent of Insurance v. Bankers Life & Casualty Co.*, *supra.*, 404 U.S. at 11-12, 92 S.Ct. at 167-168; *A. T. Brod & Co. v. Perlow*, *supra*, 375 F.2d at 396-97.

Appellee is left, then, with the argument that his fraud had no connection with the purchase or sale of securities. However, since appellee's sole purpose is participating in the misappropriation of confidential takeover information was to purchase shares of the target companies, we find little merit in his disavowal of a connection between the fraud and the purchase. *See Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974), *cert. denied*, 421 U.S. 976, 95 S.Ct. 1976, 44 L.Ed.2d 467 (1975).

In 1972, the year preceding the one in which appellee's fraudulent scheme was hatched, the Supreme Court decided *Superintendent of Insurance v. Bankers Life & Casualty Co.*, *supra*, 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128. Citing with approval both *Cooper v. North Jersey Trust Co.*, *supra*, 226 F.Supp. 972 and *A. T. Brod & Co. v. Perlow*, *supra*, 375 F.2d 393, the Court construed the phrase "in connection with" flexibly to include deceptive practices "touching" the sale of securities, *id.* 404 U.S. at 12, 92 S.Ct. at 168, a relationship which has been described as "very tenuous indeed". 1 A. Bromberg & L. Lowenfels, *Securities Fraud and Commodity Fraud*, § 4.7(574)(3) at 88.34 (1979). This Court and others have followed the teachings of the *Bankers Life* case.

In *Competitive Associates, Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 815 (2d Cir. 1975),

which involved the allegedly fraudulent certification of financial statements, we said:

> The broad 'touch' test enunciated in *Bankers Life* is certainly met by plaintiff's allegations that the very purpose of defendants' certification of Takara's financial statement was to aid in placing Yamada in a position where he could manipulate securities prices and sell these securities to investors attracted by Yamada's reputation and performance.

We reversed summary judgment in defendants' favor because, we said, that "[p]laintiff has alleged a fraudulent scheme the accomplishment of which is directly related to the trading process." *Id. See also Mansbach v. Prescott Ball & Turben, supra*, 598 F.2d at 1028; *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 594-95 (5th Cir.) *cert. denied*, 419 U.S. 873, 95 S.Ct. 134, 42 L.Ed.2d 113 (1974); *Jannes v. Microwave Communications, Inc.*, 461 F.2d 525, 528-30 (7th Cir. 1972).

In *United States v. Naftalin, supra*, 441 U.S. 768, 99 S.Ct. 2077, 60 L.Ed.2d 624, where the defendant was convicted of violating section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. § 77q(a)(1), by defrauding his broker-agent, the Court held that investor protection was not the sole purpose of the Act. *Id.* at 775, 99 S.Ct. at 2082. Justice Brennan, writing for the Court, said that a "key part" of the program evidenced by enactment of the federal securities statutes was the "effort 'to achieve a high standard of business ethics . . . *in every facet of the securities industry.*'" *Id.* (quoting *SEC v. Capital Gains Bureau, supra*, 375 U.S. at 186-87, 84 S.Ct. at 279-80 with emphasis added).

The court below, in holding that appellee could not be held criminally liable for violating Rule 10b-5 unless he defrauded a purchaser or seller, misconstrued the thrust of the Securities Acts. Moreover, putting aside the question of standing, as we must in this criminal case, we be-

lieve that Rule 10b-5's proscription of fraudulent and deceptive practices upon any person in connection with the purchase or sale of a security provided clear notice to appellee that his fraudulent conduct was unlawful. *United States v. Persky*, 520 F.2d 283, 288 (2d Cir. 1975).

THE MAIL FRAUD

The indictment charges appellee and his cohorts with devising a scheme and artifice to defraud and with misappropriating confidential information concerning mergers and acquisitions and covertly using that information to buy stock in target companies. It clearly charges appellee with fraudulent misappropriation of property that did not belong to him. Intangibles such as "confidential and nonpublic commercial information" fall within the definition of "property" under the mail fraud statute. *United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896, 99 S.Ct. 257, 58 L.Ed.2d 243 (1978). *See United States v. Von Barta*, *supra*, 635 F.2d at 1006; *United States v. Brown*, *supra*, 540 F.2d at 374; *United States v. Kelly*, 507 F.Supp. 495, 499-504 (E.D.Pa. 1981).[4]

We believe the district court misconstrued the law of this Circuit concerning fraudulent breaches of fiduciary obligations under the statute. *United States v. Von Barta*, *supra*, upon which the district court relied, did not involve fraudulent misappropriation of confidential information entrusted to an employer. *Von Barta* concerned an employee's failure to disclose material information to his employer, allegedly in breach of a fiduciary duty of honesty and loyalty. The fraudulent scheme in the instant case, like those in *United States v. Kent*, *supra*, 608 F.2d 542, and *Abbott v. United States*, *supra*, 239 F.2d 310, was more egregious. Its "object was to filch from [the employer] its valuable property by dishonest, devious, reprehensible means." *Abbott v. United States*, *supra*, at 314.

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[4] Confidential business secrets are specifically protected in a number of criminal statutes. *See, e.g.*, 18 U.S.C. § 1702; N.Y. Penal Law, §§ 155.00 & 155.30(3) (McKinney).

However, in addition to alleging fraudulent misappropriation of an employer's secret information, this indictment also alleges that the scheme included breach of the employees' fiduciary duties by material misrepresentations to the employer and non-disclosure of material information required to be disclosed. In *Von Barta* the Government had asserted the broad claim that every employee breach of a fiduciary duty of honesty and loyalty violates the mail fraud statute. Although we rejected that sweeping claim, 635 F.2d at 1002, we concluded that an employee's breach of his fiduciary obligations is actionable under the statute when it encompasses the violation of a "duty to disclose material information to his employer." *Id.* at 1006. *If Von Barta* left any doubt in the matter, and we do not believe that it did, *United States v. Bronston*, 658 F.2d 920 (2d Cir., 1981), decided after the district court's ruling in this case, clearly spelled out that "the concealment of a fiduciary of material information which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to another is a violation of the [mail fraud] statute." At 926. We do not intend, of course, that this rule be used in bootstrap fashion by finding an obligation to disclose in every breach of fiduciary duty. However, the indictment charges that Courtois and Antoniu were specifically required to report the buying activity which they concealed and that they falsely and fraudulently asserted that they maintained no direct or indirect interests in securities trading accounts. This was a sufficient averment of wrongdoing under *United States v. Bronston, supra,* and *United States v. Von Barta, supra.*[5]

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[5] The district court feared that the indictment here was an attempt to revive the broad theory of employee fiduciary liability rejected in *Von Barta*. The court cited the following portion of ¶ 10(d) of the indictment:

> In so doing, and by sharing profits from the sale of those securities with Courtois and Antoniu, Newman, Carniol and Spyropoulos aided, participated in and facilitated Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty and

The district court erred in holding that, in every mail fraud case based upon a breach of fiduciary duty by a private employee, there must be proof of "direct, tangible, economic loss to the victim, actual or contemplated." *See, United States v. Von Barta, supra,* 635 F.2d at 1006; *United States v. Dorfman,* 335 F.Supp. 675, 679 (S.D. N.Y. 1971), *aff'd,* 470 F.2d 246 (2d Cir. 1972), *cert. dismissed,* 411 U.S. 923, 93 S.Ct. 1561, 36 L.Ed.2d 317 (1973). Assuming, however, that such proof would be required in the instant case, the indictment fairly informed appellee that this was part of the charge against which he must defend. *Hamling v. United States,* 418 U.S. 87, 117, 94 S.Ct. 2887, 2907, 41 L.Ed.2d 590 (1974). Appellee could not have been unaware that confidential information, such as that involved here, has a "negative" value which is diminished when confidentiality is lost. *Abbott v. United States, supra,* 239 F.2d at 314. As discussed above, Morgan Stanley and Kuhn Loeb, and their clients as well, would almost surely be prejudiced if the veil of secrecy surrounding contemplated tender offers was fraudulently and surreptitiously lifted. At least, the jury could so find.

THE CONSPIRACY

Because dismissal of the substantive counts led to the dismissal of the conspiracy count, reinstatement of the former requires the reinstatement of the latter.

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silence owed directly to Morgan Stanley, Kuhn Loeb, and clients of those investment bankers.

However, this allegation does not rest on a theory that every employee fiduciary breach is actionable. On the contrary, the allegation is far narrower. The introductory words, "In so doing," refer to the immediately preceding allegations, which charge that Newman, along with Carniol and Spyropoulos: received covert information and advice from Antoniu and (through Antoniu) from Courtois. Based on that information and advice, Newman, Carniol and Spyropoulos opened and maintained secret foreign accounts and purchased target companies' securities through those secret foreign accounts.

DISPOSITION

The order dismissing the indictment is reversed, and the matter is remanded to the district court for further proceedings consistent with this opinion.

DUMBAULD, Senior District Judge, concurring and dissenting:

I am not certain that the deceptive practice engaged in by defendant and his confederates was a fraud "in connection with the purchase or sale of any security" and hence violative of Section 10(b) of the Securities Exchange Act of 1934 (48 Stat. 891, 15 U.S.C. § 78j). *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980) and *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975) seem to evince a trend to confine the scope of § 10(b) to practices harmful to participants in actual purchase-sale transactions.

The culprits in the case at bar (as in *Chiarella*) owed no duty to the sellers of the target company securities which they purchased. Though they deceptively and improperly violated a fiduciary duty to their employers and customers of their employers, those parties had not at that time actually purchased or sold any target company securities. All that can be said is, as Mr. Justice Stevens judiciously observes, that respectable arguments could be made in support of either position (445 U.S. at 238, 100 S.Ct. at 1120).

Hence I prefer to rest my concurrence in the reversal of the District Court's exculpation of defendant from trial for his reprehensible activities upon the more solid ground that he has clearly violated the Mail Fraud statute, 18 U.S.C. § 1341. As required by that provision, defendant is a person who "having devised . . . a scheme . . . to defraud," for the purpose of "executing such scheme" makes use of the mails.

In view of the sophisticated mechanisms employed for concealment of defendant's activities by use of foreign bank accounts, distribution of purchase orders, and utilization of confederates abroad, it is plain that the fraudulent scheme contemplated use of the mails as an integral feature of its operation and an essential incident to its successful consummation. *Pereira v. United States*, 347 U.S. 1, 8-9, 74 S.Ct. 358, 362-363, 98 L.Ed. 435 (1954). That defendant's scheme was one to defraud is explicitly demonstrated by *United States v. Von Barta*, 635 F.2d 999, 1006-1007 (2d Cir. 1980).

Accordingly, I concur in reversal of the order of the district court.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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82 Cr.

UNITED STATES OF AMERICA

—v.—

E. JAQUES COURTOIS, JR.,
JAMES MITCHELL NEWMAN, a/k/a "Barnett,"
FRANKLIN CARNIOL, and
CONSTANTINE SPYROPOULOS, a/k/a "Patrick,"
Defendants.

INDICTMENT

COUNT ONE

The Grand Jury charges:

Introduction

1. At all times relevant to this indictment, E. JACQUES COURTOIS, JR., the defendant, and Adrian Antoniu, who is named herein as a conspirator but not as a defendant, were experienced investment bankers, knowledgeable in the fields of investment banking, mergers, acquisitions, and other forms of corporate takeover and finance, and were indirect participants in the trading of securities.

2. At all times relevant to this indictment, E. JACQUES COURTOIS, JR., the defendant, was employed by Morgan Stanley & Co., Inc. ("Morgan Stanley"), an in-

vestment banking firm that, among other things, represented companies engaged in corporate mergers, acquisitions, tender offers, and other takeovers. On or about January 1, 1976 COURTOIS became a member of Morgan Stanley's merger and acquisition department and on July 1, 1977 he was made a vice-president of the firm, a title he kept until on or about February 23, 1979 when he left Morgan Stanley.

3. From on or about August 14, 1972, to May 2, 1975, Adrian Antoniu was employed as an associate in the corporate finance department of Morgan Stanley and assigned from time to time to merger and acquisition assignments. From on or about May 5, 1975, to July 26, 1978, Antoniu was employed as an associate in the mergers and acquisitions department of Kuhn, Loeb & Co. ("Kuhn Loeb"), another investment banking firm that, among other things, represented companies engaged in corporate mergers, acquisitions, tender offers and takeovers and that, after a merger of its own, became known as Lehman Brothers Kuhn Loeb Inc.

4. At all times relevant to this indictment, JAMES MITCHELL NEWMAN, a/k/a "Barnett," FRANKLIN CARNIOL, and CONSTANTINE SPYROPOULOS, a/k/a "Patrick," the defendants, were friends of Adrian Antoniu who, based on the advice and information given by Antoniu, purchased and sold securities mostly in secret foreign accounts.

a. From January of 1973 until February of 1975, NEWMAN was employed as a securities trader and manager of the over-the-counter trading department of Executive Securities Corp.

b. From April of 1973 up to and including the date of this indictment, CARNIOL was living in Europe, principally in Brussels, Belgium.

c. From September of 1975 up to and including the date of the filing of this indictment, SPYROPOULOS, a

citizen of Greece, was also living in Europe, principally in France and Greece.

5. At various times relevant to this indictment, all of the bidding companies listed below were publicly held companies or subsidiaries of publicly held companies that initiated merger, acquisition, tender offer or other take-over bids for, and/or entered into discussions and negotitions regarding the merger with or acquisition of, the publicly-held target companies listed below:

Bidding Company	Target Company
Ciba-Geigy Corp.	Funk Seeds International Inc.
North American Philips Development Corp.	Magnavox Co.
Standard Oil Company (Indiana)	Occidental Petroleum Corp.
Societe Imetal	Copperweld Corp.
Times Mirror Co.	Hudson Pulp and Paper Corp.
Hanson Industries, Inc.	Hygrade Food Products Corp.
Tenneco Inc.	Anaconda Co.
Societe Nationale des Petroles d' Aquitaine	Ventron Corp.
Marathon Energy Co.	Pan Ocean Oil Inc.
Chemische Werke Huls AG	Robintech Co.
Sandoz Seed Co.	Northrup, King & Co.
Warner-Lambert Company	Deseret Pharmaceutical Company Inc.
Tenneco Inc.	Monroe Auto Equipment Co.
Standard Chartered Bank Limited	Bancal Tri-State Corp.
Anderson Clayton & Co.	Gerber Products Co. Inc.
Crown Central Petroleum Corporation, National Cooperative Refinery Association, and Hamilton Brothers Petroleum Corporation	Kewanee Industries Inc.
Philip Morris, Inc.	Seven-Up Co.
Carter Hawley Hale Stores, Inc.	Marshall Fields Co.

6. At various times relevant to this indictment and prior to the public announcement of significant events and facts concerning the above-mentioned takeover bids and negotiations, at least one of the companies involved in each bid or negotiation was represented by either Morgan Stanley or Kuhn Loeb. Morgan Stanley represented Ciba-Geigy Corp., North American Philips Development Corp., Standard Oil Company (Indiana), Tenneco, Inc., Societe Nationale des Petroles d' Aquitaine, Pan Ocean Oil Inc., Sandoz Seed Co., Warner-Lambert Company, Standard Chartered Bank Limited, Anderson Clayton & Co., and Carter Hawley Hale Stores, Inc. Kuhn Loeb represented Societe Imetal, Hudson Pulp and Paper Corp., Hanson Industries, Inc., Robintech Co., Chemische Werke Huls AG, Crown Central Petroleum Corporation, National Cooperative Refinery Association, and Hamilton Brothers Petroleum Corporation, as well as a company called Great Basins Petroleum which for a time in 1976 was seeking a buyer. Lehman Brothers Kuhn Loeb represented Phillip Morris.

The Conspiracy

7. From on or about January 1, 1973, to on or about December 31, 1978, in the Southern District of New York and elsewhere, E. JACQUES COURTOIS, JR., JAMES MITCHELL NEWMAN, a/k/a "Barnett," FRANKLIN CARNIOL, and CONSTANTINE SPYROPOULOS, a/k/a "Patrick," the defendants, unlawfully, wilfully, and knowingly, did combine, conspire, confederate, and agree with Adrian Antoniu and other persons to the Grand Jury known and unknown to commit certain offenses against the United States, to wit: violations of Title 18, United States Code, Sections 1341 and 1343, and Title 15, United States Code, Sections 78j(b) and 78ff, Rule 10b-5 [17 C.F.R. § 240.10b-5].

8. It was a part of the conspiracy that E. JACQUES COURTOIS, JR., JAMES MITCHELL NEWMAN, a/k/a "Barnett," FRANKLIN CARNIOL, and CONSTANTINE

SPYROPOULOS, a/k/a "Patrick," the defendants, would and did devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses, representations, and promises as set forth more fully below and in Counts Two through Fourteen, and that to execute the scheme, they would and did use and caused the use of the mails, in violation of Title 18, United States Code, Section 1341, and interstate wires, in violation of Title 18, United States Code, Section 1343.

9. It was further a part of the conspiracy that E. JACQUES COURTOIS, JR., JAMES MITCHELL NEWMAN, a/k/a "Barnett," FRANKLIN CARNIOL, and CONSTANTINE SPYROPOULOS, a/k/a "Patrick," the defendants, would and did directly and indirectly, and by use of means and instrumentalities of foreign and interstate commerce, the mails, and the facilities of national securities exchanges, (a) employ devises, schemes, and artifices to defraud and (b) engage in acts, practices, and courses of business in connection with the purchase and sale of securities as more fully set forth below and in Counts Sixteen through Twenty-Seven, which operated as a fraud and deceit on Morgan Stanley, Kuhn Loeb, and those corporations and shareholders on whose behalf Morgan Stanley or Kuhn Loeb owed fiduciary duties, in violation of Title 15, United States Code, Section 78j(b) and 78ff, and Rule 10b-5 [17 C.F.R. § 240.10b-5].

OBJECTS OF THE CONSPIRACY

10. Among the objects of the conspiracy were the following:

(a) As part of the conspiracy, the defendants agreed that COURTOIS would misappropriate confidential, material information concerning mergers and acquisitions and the companies involved in merger and acquisition discussions and negotiations, which information was entrusted to Morgan Stanley by its clients. They agreed

further that COURTOIS would covertly relay such information to Antoniu and that Antoniu would, in turn, cause NEWMAN, CARNIOL and/or SPYROPOULOS, whose names were not given to COURTOIS, to purchase the securities of the companies that were the targets of the confidential merger and acquisition discussions and negotiations. In so doing, COURTOIS and his co-conspirators would and did breach the trust and confidence placed in Morgan Stanley by its clients and the trust and confidence placed in COURTOIS by Morgan Stanley, its clients and the shareholders of its clients.

(b) As part of the conspiracy, the defendants agreed that Antoniu would misappropriate confidential, material information concerning mergers and acquisitions and the companies involved in merger and acquisition discussions and negotiations, which information was entrusted to Morgan Stanley and Kuhn Loeb by their clients. They agreed further that Antoniu would advise NEWMAN, CARNIOL and/or SPYROPOULOS (sometimes hereafter referred to as the "buyers") to purchase the securities of the companies that were the targets of the confidential merger and acquisition discussions and negotiations. In so doing, Antoniu and the conspirators would and did breach the trust and confidence placed in Morgan Stanley and Kuhn Loeb by their clients and the trust and confidence placed in Antoniu by Morgan Stanley, Kuhn Loeb, their clients and the shareholders of their clients.

(c) As part of their participation in the conspiracy, COURTOIS and Antoniu (sometimes hereafter referred to as the "insiders") affirmatively misled Morgan Stanley and Kuhn Loeb by, among other things, falsely and fraudulently promising to honor their fiduciary duties to maintain the confidentiality of material, confidential information provided to them in trust and confidence by their employers and their employers' clients, by intentionally and methodically violating those fiduciary duties, by falsely and fraudulently concealing the violation of their fiduciary

duties, by failing to report the buyers' trading to their employers as required, and by falsely and fraudulently asserting that they maintained no direct or indirect interest in securities trading accounts. In so doing, COURTOIS and Antoniu, with the aid and support of the other conspirators, violated and caused each other to violate the fiduciary duties of honesty, loyalty and silence which each owed directly or indirectly to Morgan Stanley, Kuhn Loeb and their clients.

(d) As part of their participation in the conspiracy and in reliance on COURTOIS' and Antoniu's breach of fiduciary duties, NEWMAN, CARNIOL and SPYROPOULOS received covert information and advice from Antoniu and (through Antoniu) from COURTOIS. Based on that information and advice, NEWMAN, CARNIOL and SPYROPOULOS opened and maintained secret foreign accounts and purchased target companies' securities through those secret foreign accounts. In so doing, and by sharing profits from the sale of those securities with COURTOIS and Antoniu, NEWMAN, CARNIOL and SPYROPOULOS aided, participated in and facilitated COURTOIS and Antoniu in violating the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn Loeb, and clients of those investment banks.

THE MEANS OF THE CONSPIRACY

11. The means employed by the defendants and their co-conspirators to execute their conspiracy and carry out the unlawful objects set forth above were the following:

a. In or about the latter part of 1973, JAMES MITCHELL NEWMAN and Adrian Antoniu agreed that Antoniu, as a Morgan Stanley associate entrusted with access to information about impending or proposed mergers and acquisitions, would and did use his position to misappropriate such confidential information by leaking to Newman, among other things, the names of the companies

targeted for acquisition or merger. NEWMAN, in turn, would and did purchase the securities of target companies before public announcements of such merger and acquisition plans, information about which had been secretly provided to him by Antoniu. It was understood and expected that, after the public announcement, when the price of each stock rose, NEWMAN would sell the securities and covertly share with Antoniu half of all profits realized and cover half of any losses incurred through the scheme.

b. Shortly after making this arrangement with NEWman, Antoniu agreed with CARNIOL and SPYROPOULOS to follow trading and profit-sharing arrangements similar to those already described in subparagraph (a) herein.

c. As part of his arrangements with each of his buyers, Antoniu misappropriated and leaked confidential information concerning merger and acquisition bids for a number of companies, including Funk Seeds International, Inc., Magnavox Co., Occidental Petroleum Corp., Copperweld Corp., Hudson Pulp and Paper Corp. and Hygrade Food Products Corp. to NEWMAN, CARNIOL and SPYROPOULOS.

d. Not long after the birth of this conspiracy, and in order to carry out their individual roles in it, NEWMAN, CARNIOL and SPYROPOULOS each opened or caused to be opened secret foreign bank accounts. Through these bank accounts each of the buyers was able to secretly place orders for the purchase and sale of securities without having his name or the names of COURTOIS or Antoniu appear on brokerage or stock exchange records. To this end, NEWMAN traded in the name of trust accounts in the Bahamas and Bermuda; CARNIOL traded through bank accounts in Luxembourg protected by that country's bank secrecy laws; and SPYROPOULOS traded in similar accounts in Switzerland protected by that country's bank secrecy laws.

e. In late 1975, the defendant COURTOIS joined the conspiracy, agreeing to use his position to misappropriate and leak to Antoniu the confidential, material information he obtained as a trusted member of Morgan Stanley's merger and acquisition department regarding impending or proposed merger and acquisition bids and the companies involved in such bids.

f. As a result of this arrangement and, with the understanding that Antoniu would conceal COURTOIS' identity even from NEWMAN, CARNIOL and SPYROPOULOS, COURTOIS leaked to Antoniu, among other things, the names of target companies including but not limited to Anaconda Co., Ventron Corp., Pan Ocean Oil Inc., Northrup, King & Co., Deseret Pharmaceutical Company, Inc., Monroe Auto Equipment Co., Bancal Tri-State Corp., Gerber Products Co., Inc. and Marshall Fields Co. Antoniu, in turn, passed those company names to NEWMAN, CARNIOL and SPYROPOULOS, who bought or caused to be bought, mostly in secret accounts, the securities of those companies.

g. It was agreed and understood by and between the conspirators that COURTOIS and Antoniu would each receive one-third of all profits and share in one-third of any loses realized upon the sale of all stocks purchased based on COURTOIS' leak of confidential information.

h. Following COURTOIS' initiation into the conspiracy, Antoniu continued to leak to NEWMAN, CARNIOL and SPYROPOULOS confidential information regarding facts and events in impending or proposed merger and acquisition transactions which he (Antoniu) received as a trusted employee of Kuhn Loeb, including the names of the following target companies: Robintech Co., Kewanee Industries Inc. and Seven-Up Co.

i. It was agreed and understood by and between the conspirators that Antoniu would receive one-half of all profits and share in one-half of any losses realized as a

result of transactions generated from his own leaks from Kuhn Loeb.

j. It was further agreed and understood by and between the conspirators that all of the conspirators would conceal their misappropriation of confidential information from Morgan Stanley, Kuhn Loeb, their clients and their client's shareholdings by, among other things, avoiding any use of the names of the insiders COURTOIS and Antoniu or any other action that would reveal COURTOIS' and Antoniu's interest in NEWMAN'S, CARNIOL'S and SPYROPOULOS' accounts, by making any and all payments in cash or through secret bank accounts, by avoiding meetings with or between or telephone calls to COURTOIS or Antoniu at Morgan Stanley or Kuhn Loeb, by the occasional use of aliases to conceal their true identity when leaving messages, by the use of foreign secret accounts, by attempting to use multiple foreign banks and/or multiple brokers to execute their trades, and by making false and misleading statements, when necessary, to any governmental or stock exchange personnel who should inquire about any of the conspirators' securities trading activity.

OVERT ACTS

In furtherance of the conspiracy and to effect its objects, the following overt acts, among others, were committed in the Southern District of New York and elsewhere:

1. In or about the first half of 1973 JAMES NEWMAN and Adrian Antoniu had a series of conversations in New York City.

2. In or about the latter part of 1973 CONSTANTINE SPYROPOULOS and Adrian Antoniu had a conversation in Manhattan.

3. In or about September, 1974 FRANKLIN CARNIOL and Adrian Antoniu had a meeting in Brussels, Belgium.

4. In or about the late winter or spring of 1975 E. JACQUES COURTOIS, JR. and Adrian Antoniu had several conversations in Manhattan.

5. On or about May 17, 1975 FRANKLIN CARNIOL and Adrian Antoniu had a meeting in Manhattan.

6. On or about August 7, 1975 FRANKLIN CARNIOL had a telephone conversation with Adrian Antoniu in Manhattan.

7. On or about August 8, 1975 FRANKLIN CARNIOL had a telephone conversation with Adrian Antoniu who was in Manhattan.

8. On or about August 13, 1975 FRANKLIN CARNIOL had a telephone conversation with Adrian Antoniu who was in Manhattan.

9. In or about August of 1975 E. JACQUES COURTOIS gave two United States Treasury Bills to Antoniu in Manhattan, Antoniu passed these two Treasury Bills on to NEWMAN, and NEWMAN deposited them in a Manhattan bank.

10. In or about late autumn or early winter 1975, Adrian Antoniu met with E. JACQUES COURTOIS, JR. in Manhattan.

11. On or about December 9, 1975, in Manhattan JAMES NEWMAN gave false testimony in a deposition concerning the bankruptcy of a brokerage house.

12. On or about December 12, 1975, JAMES NEWMAN, in Manhattan, deposited two United States Treasury Bills.

13. On or about April 26, 1976 JAMES NEWMAN received three United States Treasury Bills in Manhattan.

14. On or about April 28, 1976 JAMES NEWMAN received one United States Treasury Bill in Manhattan.

15. On or about May 10, 1976 JAMES NEWMAN, in Manhattan deposited four United States Treasury Bills.

16. On or about June 30, 1976 JAMES NEWMAN, in Manhattan, received two United States Treasury Bills.

17. On or about August 31, 1976, JAMES NEWMAN, in Manhattan received four United States Treasury Bills.

18. On or about September 2, 1976 JAMES NEWMAN picked up two United States Treasury Bills in Manhattan.

19. On or about October 18, 1976, JAMES NEWMAN, in Manhattan received eight United States Treasury Bills.

20. On or about November 10, 1976, JAMES NEWMAN, in Manhattan received two United States Treasury Bills.

21. On or about November 30, 1976 E. JACQUES COURTOIS made a telephone call to Antoniu who was in Manhattan and who, in turn, contacted JAMES NEWMAN and FRANKLIN CARNIOL.

22. On or about January 21, 1977 JAMES NEWMAN made seven telephone calls from Florida to Bermuda.

23. On or about January 24, 1977 JAMES NEWMAN made two telephone calls to Antoniu, who was in Manhattan.

24. On or about January 26, 1977 JAMES NEWMAN made a telephone call to Antoniu, who was in Manhattan.

25. On or about February 7, 1977 JAMES NEWMAN made three telephone calls to Antoniu, who was in Manhattan.

26. On or about March 29, 1977 JAMES NEWMAN made a telephone call from Florida to Bermuda.

27. On or about March 30, 1977 JAMES NEWMAN made two telephone calls from Florida to Bermuda.

28. On or about March 31, 1977 JAMES NEWMAN made two telephone calls from Florida to Bermuda.

29. On or about April 1, 1977 JAMES NEWMAN made three telephone calls from Florida to Bermuda.

30. On or about April 7, 1977 JAMES NEWMAN made a telephone call from Florida to Bermuda.

31. On or about November 11, 1977 FRANKLIN CARNIOL caused funds to be transferred from Brussels, Belgium to an account in New York.

32. On or about November 15, 1977 FRANKLIN CARNIOL caused funds to be transferred from Brussels, Belgium to an account in New York.

33. On or about November 28, 1977 FRANKLIN CARNIOL caused funds to be transferred from Brussels, Belgium to an account in New York.

34. In or about late December of 1977 CONSTANTINE SPYROPOULOS met Adrian Antoniu in Switzerland.

35. In or about July of 1978 COURTOIS, who was in Manhattan, and Antoniu, who was in Greece, spoke by telephone.

36. In or about August of 1978 E. JACQUES COURTOIS, JR. and Antoniu met in Manhattan.

37. In or about September of 1978 FRANKLIN CARNIOL and Adrian Antoniu met in London, England.

(Title 18, United States Code, Section 371.)

COUNTS TWO THROUGH FOURTEEN

The Grand Jury further charges:

12. From on or about January 1, 1973 up to and including December 31, 1978 in the Southern District of New York and elsewhere, E. JACQUES COURTOIS, JR., JAMES MITCHELL NEWMAN a/k/a "Barnett," and

FRANKLIN CARNIOL, the defendants, did unlawfully, wilfully and knowingly devise and intend to devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses, representations, and promises as alleged in paragraphs one through eleven above.

13. On or about the dates set forth below, in the Southern District of New York, E. JACQUES COURTOIS, JR., JAMES MITCHELL NEWMAN, a/k/a "Barnett," and FRANKLIN CARNIOL, the defendants, as indicated below in the "Defendants Charged" column and with respect to the counts below in which their names are listed, unlawfully, wilfully and knowingly, for the purpose of executing said scheme and artifice and attempting to do so, did cause to be placed in post offices and authorized depositories for mail matter in New York City, and did cause to be delivered by the United States Postal Service according to the directions thereon, mail matter and things addressed to various foreign banks and persons, as more particularly set forth below:

COUNT	SECURITY PURCHASED	APPROX-IMATE DATE OF MAILING	MATTER OR THING	ADDRESSEE	DEFENDANTS CHARGED
2	Ventron Corp.	2/3/76	Confirmation	Bank of N.T. Butterfield & Son, Ltd. P.O. Box 1735 Hamilton, Bermuda	COURTOIS NEWMAN
		2/5/76	Confirmation	The Bank of Bermuda Ltd. Front Street Hamilton, Bermuda	
3	Pan Ocean Oil Inc.	3/31/76	Confirmation	The Bank of Bermuda Ltd. Front Street Hamilton, Bermuda	COURTOIS NEWMAN
4	Pan Ocean Oil Inc.	3/31/76	Confirmation	Banque Benelux Luxembourg 10 Rue Aldringer Luxembourg	COURTOIS CARNIOL
5	Northrup, King & Co.	8/24/76 9/20/76 10/7/76	Confirmation Confirmation Confirmation	The Bank of Bermuda Ltd. Front Street Hamilton, Bermuda	COURTOIS NEWMAN

COUNT	SECURITY PURCHASED	APPROX-IMATE DATE OF MAILING	MATTER OR THING	ADDRESSEE	DEFENDANTS CHARGED
6	Northrup, King & Co.	10/7/76	Confirmation	Banque De Paris Et Pays Bas 1 Place De La Gare Luxembourg	COURTOIS CARNIOL
7	Deseret Pharmaceutical Company, Inc.	11/30/76	Confirmation	The Bank of Bermuda Ltd. Front Street Hamilton, Bermuda	COURTOIS NEWMAN
8	Deseret Pharmaceutical Company, Inc.	11/30/76	Confirmation	Banque De Paris Et Pays Bas 1 Place De La Gare Luxembourg	COURTOIS CARNIOL
		11/30/76	Confirmation	Banque Benelux 10 Rue Aldringer Luxembourg	
9	Monroe Auto Equipment	12/3/76 12/6/76 12/7/76 12/9/76	Confirmation Confirmation Confirmation Confirmation	The Bank of Bermuda Ltd. Front Street Hamilton, Bermuda	COURTOIS NEWMAN
10	Bancal Tri-State Corp.	2/7/77	Confirmation	Madame Lut Vermeiren 2 Rue Toulouse Lautrec 91260 Antony, France	COURTOIS CARNIOL

		2/3/77	Confirmation	Banque De Paris Et	
		2/4/77	Confirmation	Pays Bas	
		2/7/77	Confirmation	1 Place De La Gare	
				Luxembourg	
		2/4/77	Confirmation	Banque Benelux	
		2/7/77	Confirmation	10 Rue Aldringer	
				Luxembourg	
11	Bancal	2/8/77	Confirmation	The Bank of Bermuda	COURTOIS
	Tri-State	2/9/77	Confirmation	Ltd.	NEWMAN
	Corp.	2/10/77	Confirmation	Front Street	
		2/11/77	Confirmation	Hamilton, Bermuda	
		2/14/77	Confirmation		
12	Gerber	3/11/77	Confirmation	Madame Lut Vermeiren	COURTOIS
	Products			2 Rue Toulouse Lautrec	CARNIOL
				91260 Antony, France	
		3/11/77	Confirmation	Banque De Paris Et	
		3/14/77	Confirmation	Pays Bas	
		4/7/77	Confirmation	1 Place De La Gare	
		4/11/77	Confirmation	Luxembourg	
		3/11/77	Confirmation	Banque Benelux-	
				Banque Suez	
				10 Rue Aldringer	
				Luxembourg	
		3/17/77	Confirmation	Societe Generale	
				Alsacienne De Banque	
				15 Rue Del Arsenal	
				Luxembourg	

COUNT	SECURITY PURCHASED	APPROX-IMATE DATE OF MAILING	MATTER OR THING	ADDRESSEE	DEFENDANTS CHARGED
13	Gerber Products	3/29/77 3/30/77 3/31/77	Confirmation Confirmation Confirmation	Bank of N.T. Butterfield & Son Ltd. P.O. Box 1735 Hamilton, Bermuda	COURTOIS NEWMAN
14	Kewanee Industries Inc.	4/25/77	Confirmation	Banque Benelux-Banque Suez 10 Rue Aldringer Luxembourg	CARNIOL

14. The allegations contained in all the preceding paragraphs of Count One of this Indictment are repeated and realleged as though fully set forth herein and as constituting and describing part of the scheme by which the defendants COURTOIS, NEWMAN, CARNIOL and others committed the offenses charged in these Counts.

(Title 18, United States Code, Sections 1341 and 2.)

COUNTS FIFTEEN THROUGH TWENTY-SEVEN

The Grand Jury further charges:

15. On or about the dates listed below, in the Southern District of New York and elsewhere, E. JACQUES COURTOIS, JR., JAMES MITCHELL NEWMAN a/k/a "Barnett," and FRANKLIN CARNIOL, the defendants, as indicated in the "Defendants Charged" column below and with respect to the Counts in which their names are listed, unlawfully, wilfully and knowingly, by use of means and instrumentalities of interstate commerce, the mails and the facilities of national securities exchanges, as alleged in paragraphs one through eleven above, did directly and indirectly, (a) employ devices, schemes, and artifices to defraud and (b) engage in acts, practices, and courses of business which operated as a fraud and deceit on Morgan Stanley, Kuhn Loeb, and those corporations and shareholders on whose behalf Morgan Stanley or Kuhn Loeb was acting, and to whom Morgan Stanley or Kuhn Loeb owed fiduciary duties, in connection with the purchase of securities, including the following:

COUNT	SECURITY PURCHASED	APPROXIMATE DATES OF PURCHASE	NUMBER OF SHARES	DEFENDANTS CHARGED
15	Ventron Corp.	2/3/76 2/5/76	500 200	COURTOIS/NEWMAN
16	Pan Ocean Oil Inc.	3/31/76	1000	COURTOIS/NEWMAN
17	Pan Ocean Oil Inc.	3/31/76	1000	COURTOIS/CARNIOL
18	Northrup, King & Co.	8/24/76 8/24/76 8/24/76 8/24/76 9/20/76 9/20/76 9/20/76 10/7/76	300 4000 5500 200 1500 1500 500 10,000	COURTOIS/NEWMAN
19	Northrup, King	10/7/76	1000	COURTOIS/CARNIOL
20	Deseret Pharmaceutical Company, Inc.	11/30/76 11/30/76 11/30/76 11/30/76 11/30/76 11/30/76	100 2700 1100 1100 500 500	COURTOIS/NEWMAN

21	Deseret	11/30/76	100	COURTOIS/CARNIOL
	Pharmaceutical	11/30/76	100	
	Company, Inc.	11/30/76	2000	
		11/30/76	2000	
		11/30/76	700	
		11/30/76	800	
22	Monroe Auto	12/3/76	3000	COURTOIS/NEWMAN
	Equipment	12/6/76	800	
	Co.	12/6/76	3000	
		12/6/76	3300	
		12/6/76	1700	
		12/7/76	5000	
		12/9/76	5000	
23	Bancal	2/3/77	600	COURTOIS/CARNIOL
	Tri-State	2/4/77	100	
	Corp.	2/4/77	100	
		2/4/77	100	
		2/4/77	300	
		2/4/77	400	
		2/4/77	400	
		2/4/77	200	
		2/4/77	200	
		2/4/77	1600	
		2/7/77	4000	
		2/7/77	100	
		2/7/77	700	
		2/7/77	900	
		2/7/77	900	

COUNT	SECURITY PURCHASED	APPROXIMATE DATES OF PURCHASE	NUMBER OF SHARES	DEFENDANTS CHARGED
		2/7/77	1000	
		2/7/77	2000	
		2/7/77	2300	
		2/7/77	4000	
		2/7/77	4100	
		2/7/77	100	
		2/7/77	1100	
24	Bancal Tri-State Corp.	2/8/77	200	COURTOIS/NEWMAN
		2/8/77	2800	
		2/8/77	2000	
		2/8/77	1000	
		2/9/77	1100	
		2/9/77	2900	
		2/10/77	2000	
		2/11/77	1500	
		2/14/77	1500	
25	Gerber Products Co.	3/11/77	1500	COURTOIS/CARNIOL
		3/11/77	700	
		3/11/77	3300	
		3/11/77	1000	
		3/14/77	300	
		3/14/77	900	
		3/14/77	1000	
		3/14/77	1800	
		3/17/77	100	

		3/17/77	1900	
		3/17/77	3000	
		4/7/77	400	
		4/11/77	1500	
26	Gerber Products Co., Inc.	3/29/77	500	COURTOIS/NEWMAN
		3/30/77	1500	
		3/31/77	2000	
27	Kewanee Indsutries Inc.	4/25/77	4000	CARNIOL

16. The allegations contained in all the preceding paragraphs of Count One of this Indictment are repeated and realleged as though fully set forth herein and as constituting and describing part of the scheme by which the defendants COURTOIS, NEWMAN, CARNIOL and others committed the offenses charged in these Counts.

(Title 15, United States Code, Sections 78j(b) and 78ff, Rule 10b-5 [17 C.F.R. § 240.10b-5] and Title 18, United States Code, Section 2.)

FOREPERSON

JOHN S. MARTIN, JR.
United States Attorney

[3475] UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

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82 Crim. 166 (CSH)

UNITED STATES OF AMERICA

v.

JAMES MITCHELL NEWMAN,
a/k/a "Barnett."

May 20, 1982

9:45 a.m.

(Trial resumed.)

(In open court, jury present.)

THE COURT: Will the marshal kindly secure the court for the charge to the jury.

THE CLERK: The judge is about to charge the jury. Anybody wishing to leave will do so now or remain seated for the rest of the charge.

THE COURT: Members of the jury, we now approach the conclusion of this trial in which you have all served with patience and dedication, and I am aware with a very real measure of personal inconvenience. But I do hope that you are aware of the importance of your service to this court and to the proper administration of justice.

You are acting in furtherance of a great tradition. For centuries in our legal system it has been the right of an individual charged with crime [3476] to require that the facts be found by a jury chosen from his fellow citizens. The Judge, an officer of the court, does not find the

facts. Rather the facts are found by citizen jurors, and we regard that tradition as a bulwark against the possible tyranny of government. In keeping with that tradition, you will find the facts in this case.

But there is a second tradition which complements the first and is equally important to the administration of justice. The trial judge instructs the jurors on the law they are to apply to the case and the jurors are bound to accept those instructions, even if they feel that the law should be something different from what the judge says it is.

It is often said that ours is a government of laws and not of men and women. An ordered society requires the stability and predictability of the rule of law, and if jurors in any particular case could make up and apply whatever rules of law seemed proper to them at the time, then we would pass from possible tyranny to certain anarchy.

In consequence, you will find the facts in this case and you will accept the law as I state it to you in these instructions and apply that law to the [3477] facts as you find them, and the logical result of that application will be the verdict that you will return. And if we both perform our functions properly, you and I, then the cause of justice will have been served in this case, whatever your verdict may be.

My charge will take some time. We may take a break during the course of the charge. I know it is warm. If any of you want to take a personal break at any time, simply raise your hand and let me know.

During your deliberations you may hear any part of this charge again, and I will answer any questions you may have. You may also have portions of the testimony read to you or exhibits sent in to you.

The charge will cover several subjects: First, I will instruct you on certain principles of law which apply to all criminal cases; second, I will instruct you on the particular crimes the government charges against this defendant

and what the government must prove to sustain those charges; third, I will instruct you on additional particular rules of law which apply to this case; and, finally, I will instruct you on the manner in which you should conduct your deliberations and report your verdict.

I am deeply grateful to you, as we all are, [3478] for the faithful attendance you have given in this trial, and I am confident that you are fully prepared to discharge your final duty. You are to perform your duty as jurors in an attitude of complete fairness and impartiality, without bias for or against the government or the defendant.

As counsel have properly pointed out, this is an important case. It is important to the defendant who is charged with serious crimes. Equally, it is important to the government, for the enforcement of criminal law is a prime concern to the community and to its welfare.

I should add that the fact that the government is a party entitles it to no greater consideration than that accorded to any other party in litigation. By the same token, the government is entitled to no less consideration. All parties, government and individuals alike, stand in our country as equals before the bar of justice.

Your final role is to decide and to pass upon the fact issues in this case. You are the sole and exclusive judges of the facts. You determine the weight of the evidence, you appraise the credibility of witnesses, you draw the reasonable inferences to be [3479] drawn from the evidence or lack of evidence and you resolve such conflicts as there may be in the evidence.

I will refer later to how you determine the credibility of witnesses.

With respect to any fact matter, your recollection and yours alone governs. Anything that counsel either for the government or for the defendant may have said with respect to matters in evidence, whether during the trial, in a question or in argument, is not to be substituted for your own recollection of the evidence. So too anything I may have said during the trial or may say during the

course of these instructions as to any fact matter is not to be taken in place of your own recollection.

During the trial I have been called upon to make rulings on various questions. After questions were put there may have been objections. There have been conferences at the side bar. You are to disregard all these matters. You are to disregard the fact that an objection was made and sustained or overruled or that conferences took place. These are matters of law with which you should not be concerned.

Of course, if I have instructed you to disregard anything that was said, you must follow that [3480] instruction and pay no attention to whatever it was in your deliberations.

The fact that I may have commented from time to time during the course of the trial or asked a question or two of a witness does not indicate any feeling of mine about the facts one way or the other. I have no such feelings. My questions were intended only to clarify the issue at hand.

What, then, does the evidence which you are to consider consist of? It is the evidence of witnesses who appeared before you, together with documents and other objects which have been received and exhibits and certain stipulations of counsel.

A further word on the nature of evidence. The law recognizes two kinds of evidence, direct evidence and circumstantial evidence.

Direct evidence is where a person testifies to what he himself saw or heard or that which he has knowledge of by virtue of his own senses.

Circumstantial evidence consists of proof of facts and circumstances from which in terms of common experience one may reasonably infer the ultimate fact sought to be established. Such evidence, if believed, is of no less value than direct evidence, for in either [3481] case the essential elements of the crimes charged must be established by the government beyond a reasonable doubt.

Let me give you an example of circumstantial evidence, just so you can see what I mean. Put the case of Robinson Crusoe in his boat approaching the island. He has never seen the island before. He doesn't know if there is human existence on board the island. He is interested in that, but he has no direct evidence of whether there is or not.

As his boat comes closer to the island, he can see the marks of footsteps going around and around the island. From that observation he can draw a logical inference as to whether or not some human being has arrived on that island before him. An example, you see, of circumstantial evidence.

In this case the government has relied on both direct and circumstantial evidence to sustain its burden of proof in regard to the crimes charged.

I have spoken to you of inferences to be drawn from circumstantial evidence. This is what the law means when it speaks of inferring one thing from another. An inference is the deduction or conclusion that reason and common sense prompt a reasonable mind to [3482] draw from facts which have been proven by direct evidence. Not all logically possible conclusions are legitimate or fair inferences. Only those inferences to which the mind is reasonably led or directed are fair inferences from the direct or circumstantial evidence in the case.

Whether or not to draw a particular inference is, of course, a matter exclusively for you, as are all determinations of facts in this case.

How are you to appraise or to weigh the evidence which has been presented? I mentioned at the very beginning of the trial before you heard any testimony that it was important for you not only to listen to the witnesses carefully, but to listen to direct and cross examination and to observe the witness carefully. Perhaps you now understand why I suggested this.

Your determination of the credibility of a particular witness very largely depends upon the impression that he

made upon you as to whether he was giving an accurate version of what happened. It is frequently said to jurors that when you walk into the courtroom, when you sit in the jury box, while the trial is going on or when you are deliberating, you do not [3483] leave your common sense or your experience in life behind you.

The degree of credibility to be given a witness should be determined by the witness' demeanor, by his relationship to the controversy or the parties, if any, his bias or impartiality, the reasonableness of the statements, the strength or weakness of recollection, viewed in the light of all the other testimony and the attendant circumstances in the case.

The question really is, how did the witness impress you? Did the witness' version appear straightforward and candid or did the witness try to hide some of the facts? Is there a motive of any kind to testify falsely? In other words, what you try to do, in the vernacular, is to size a person up, just as you would do in any important matter where you are undertaking to determine whether or not a person is truthful, candid and straightforward.

In passing upon the credibility of a witness you may also take into account inconsistencies or contradictions as to the matters of the testimony or any inconsistencies, omissions or admissions of false statements the witness may have made on prior occasions. I am not saying any such incidents have occurred in this [3484] trial. That is for you to say. I am simply instructing you as to how you may evaluate credibility.

There are specific instructions which I will give you a little later on with respect to certain of the witnesses who appeared before you. But you must keep in mind that the ultimate question for you to decide in passing upon the credibility of any witness is, did the witness from the witness stand tell the truth before you in this courtroom? It is for you to say whether his testimony is truthful in whole or in part, in light of the witness' demeanor, explanations and all the evidence in the case.

If you find that a witness has testified wilfully and falsely to any material fact, then you may reject the testimony of that witness entirely or you may accept such part or portions as commend themselves to your belief as credible or which you find were corroborated by other independent evidence in the case.

Although many witnesses appeared on behalf of the prosecution during the course of this trial and many documents and other exhibits were introduced into evidence by the prosecution, the mere number of witnesses or exhibits has no relation to the burden of proof to which I will shortly refer and is not to have [3485] any effect upon your deliberations. Your primary concern is the quality of the evidence and not its quantity.

* * * *

[3486] you must not permit the number of witnesses and documents supplied here to overwhelm your judgment. It is your duty to determine what weight is to be given to the evidence in this case and the weight of the evidence and its value is by no means determined by the number of witnesses or the quantity of documents.

Furthermore, you must consider the testimony of each witness, whether called by the government or by the defendant, not as it stood upon direct examination alone, but as it may have stood modified and qualified, if you find it to have been so, upon cross-examination.

The defendant, Mr. Newman, has not testified in this case. That is his absolute right, and in no respect may his election not to testify be considered by you as any evidence against him or as a basis for any presumption or inference against him. You must not permit such fact to weigh against the defendant, nor should it enter in any way whatsoever in your deliberations or discussions. Nor should you speculate in any way as to the reason why the defendant chose not to testify. You simply must not consider it at all. That is a most important principle of our law and I charge it to you with all the strength at my command.

I now turn to certain additional principles [3487] of law which apply to every criminal case and to which I made reference and emphasized at the time of your selection as jurors. I repeat them now.

The defendant has been charged by way of an indictment with the commission of crimes. In a moment I will explain the nature of the charges. I wish to emphasize now, however, that an indictment is no more than a formal method of accusing a person of having committed a crime. An indictment is not evidence of any kind against the defendant and does not create any presumption or permit any inference that he is guilty of anything. No weight whatsoever is to be given to the fact that an indictment has been returned against this defendant.

The defendant, James Newman, has pleaded not guilty. Thus the government has the burden of proving the charges against him beyond a reasonable doubt. The defendant does not have to prove his innocence. On the contrary, he is presumed to be innocent of the accusations contained in the indictment.

The presumption of innocence is not a mere formality. It is vitally important and each juror is bound to honor it conscientiously, sincerely and ungrudgingly, without any mental reservation whatsoever, [3488] and to give the defendant the full benefit of the presumption of innocence.

That presumption of innocence was in the defendant's favor at the start of this trial. It continued in his favor throughout the entire trial. It is in his favor even as I instruct you now. It remains in his favor during the course of your deliberations in the jury room. It is removed only if and when you are satisfied that the government has sustained its burden of proving the guilt of the defendant upon a particular charge beyond a reasonable doubt.

The question that naturally arises is what is a reasonable doubt. The words almost define themselves. It is a doubt founded in reason and arising out of the evidence

in the case or the lack of evidence. It is a doubt which a reasonable person has after carefully weighing all the evidence. Reasonable doubt is a doubt which appeals to your reason, your judgment, your common sense and your experience. It is not caprice, whim, speculation, conjecture or suspicion. It is not an excuse to avoid the performance of an unpleasant duty. It is not sympathy for a defendant.

If after a fair and impartial consideration of all the evidence or the lack of evidence you can [3489] candidly and honestly say that you are not satisfied of the guilt of the defendant, that you do not have an abiding conviction of his guilt, in sum, if you have such doubt as would cause you as prudent persons to hesitate in acting in a matter of importance to yourselves, then you have a reasonable doubt. In that circumstance it is your duty to acquit the defendant of the charge under consideration.

On the other hand, if after such a fair and impartial consideration of all the evidence you can candidly and honestly say that you do have an abiding conviction of the guilt of the defendant, such a conviction as you would be willing to act upon in the personal affairs of your own life, then you have no reasonable doubt, and in that circumstance it is your duty to convict the defendant of the charge under consideration.

One final word on this subject. Reasonable doubt does not mean a positive certainty or beyond all possible doubt. If that were the rule, few persons, however guilty they might be, would be convicted. It is practically impossible for a person to be absolutely and completely convinced of any disputed fact which by its nature is not susceptible of mathematical certainty. In [3490] consequence, the law in a criminal case is that it is sufficient if the guilt of the defendant is established beyond a reasonable doubt and not beyond all possible doubt.

The indictment uses the word "count." Counsel have used that word in their statements. I will use it in my instructions to you today. It is a technical lawyers' word. The word "count" in a criminal indictment means charge

or accusation. A count in an indictment is in effect an accusation that the defendant has violated the law in a particular way.

Where an indictment charges the defendant with more than one violation of the criminal law, then it contains more than one count. In this case the defendant is charged in 15 separate counts. Each count charges a separate crime, and although there may be facts common to each of the counts, each count must be considered separately and a separate verdict rendered as to each.

Let us now consider in summary the charges against the defendant. The indictment charges that the defendant, Mr. Newman, and others, engaged in a scheme to misappropriate confidential material nonpublic information from the investment banking firms of Morgan [3491] Stanley and Kuhn, Loeb and to use that information to purchase securities, in violation of federal statutes, namely, the mail fraud statute and the conspiracy statute and the federal securities laws themselves.

Count 1 charges the defendant with conspiracy to violate various provisions of the federal mail fraud statute and the federal securities statute. Counts 2, 3, 5, 7, 9, 11 and 13 charge the defendant with actual violations of the federal mail fraud statute. The remaining counts, Counts 15, 16, 18, 20, 22, 24 and 26, charge the defendant with actual violations of the federal securities statute relating to the use of fraudulent or deceitful devices or schemes in connection with the purchase or sale of securities.

In the indictment as returned by the grand jury, as you will see, other individuals were named in other counts, but you are concerned in this trial only with the counts involving Mr. Newman, who is the only defendant to appear before you. I will discuss the statutes involved in more detail later.

I remind you again that the indictment is no more than a charge of certain violations and is not to be taken as any evidence whatsoever that the defendant [3492] in fact committed any of the crimes charged therein. The

issue of the defendant's guilt or innocence is entirely for you to determine on the basis of all the evidence or lack of evidence as you view the case.

I will furnish to you for your consideration in the jury room copies of the indictment so that you will have it before you when you deliberate. Count 1 is the conspiracy count. The remaining counts in the indictment, which charge actual violations of specific federal statutes, are referred to as substantive counts.

A brief word as to the nature and difference between the conspiracy count and the substantive counts. A conspiracy to commit a crime is an entirely separate and different offense from the substantive crimes which may be the objectives of the conspiracy. The essence of the crime of conspiracy is the agreement, understanding or scheme to violate criminal laws.

Collective criminal agreement, partnership in crime, presents a greater potential threat to the public than the lone wrongdoer. Concerted action for criminal purposes makes possible the attainment of ends more complex than those which an individual acting alone could accomplish. Group association increases the likelihood that the criminal objective will be [3493] successfully realized and renders detection more difficult than in the case of the elicit activity of a single individual.

It was for these and other reasons that the Congress made a conspiracy or a concerted action to violate a federal law a crime entirely separate, distinct and different from the violation of the law or laws which may be the objective of the conspiracy. Thus Congress has provided in the statute:

"If two or more persons conspire to commit any offense against the United States, and one or more persons do any act to effect the object of the conspiracy, each shall be guilty of a crime."

I have quoted from Title 18, United States Code, Section 371, which you will see is referred to in Count 1 of the indictment.

This is the law which defendant is charged with violating in the first or conspiracy count. Under this law if a conspiracy exists, even if it should fail in its purpose, it is still punishable as a crime.

In the conspiracy charge there is no need to prove an actual violation of the other laws. On the other hand, in the substantive count the government to sustain its charge must establish that the claimed [3494] violation of a specific statute in fact occurred.

In the present indictment the substantive counts involving Mr. Newman are found in Counts 2, 3, 5, 7, 9, 11, 13, 15, 16, 18, 20, 22, 24 and 26.

In this case the government charges in Count 1 that the defendant conspired with others to commit the actual violations of federal law which are referred to in the remaining counts of the indictment, the substantive counts which I have just listed for you.

While, as I have said, it is not necessary in a conspiracy charge for the government to prove an actual violation of the pertinent law, the government charges in this case that the defendant not only conspired to violate particular provisions of federal law, but that he did in fact commit those violations.

We will now consider the crimes charged in the indictment in more detail. First let us take up the conspiracy count. I will read from the indictment, reminding you again, of course, that the fact that a grand jury returned the indictment is no evidence of the defendant's guilt.

In Count 1 of the indictment the grand jury charges as follows:

"Introduction.

[3495] "1. At all times relevant to this indictment, E. Jacques Courtois, Jr., the defendant," Mr. Newman, "and Adrian Antoniu, who is named herein as a conspirator but not as a defendant, were experienced investment bankers, knowledgeable in the fields of investment banking, mergers, acquisitions, and other forms of corporate

takeover and finance, and were indirect participants in the trading of securities.

"2. At all times relevant to this indictment, E. Jacques Courtois, Jr., the defendant"—I should make it clear, I think, that in this preamble the phrase "the defendant" refers to Mr. Courtois and not to Mr. Newman. I may have misstated that when I read it to you at first. Resuming the reading of paragraph 2.

"At all times relevant to this indictment, E. Jacques Courtois, Jr., the defendant, was employed by Morgan Stanley & Company, Inc., Morgan Stanley, an investment banking firm that, among other things, represented companies engaged in corporate mergers, acquisitions, tender offers, and other takeovers. On or about January 1, 1976 Courtois became a member of Morgan Stanley's merger and acquisition department and on July 1, 1977 he was made a vice-president of the firm, a title he kept until on or about February 23, 1979, when [3496] he left Morgan Stanley.

"3. From on or about August 14, 1972, to May 2, 1975, Adrian Antoniu was employed as an associate in the corporate finance department of Morgan Stanley and assigned from time to time to merger and acquisition assignments. From on or about May 5, 1975, to July 26, 1978, Antoniu was employed as an associate in the mergers and acquisitions department of Kuhn, Loeb & Co., another investment banking firm that, among other things, represented companies engaged in corporate mergers, acquisitions, tender offers and takeovers and that, after a merger of its own, became known as Lehman Brothers Kuhn, Loeb Inc.

"4. At all times relevant to this indictment, James Mitchell Newman, also known as Barnett, Franklin Carniol and Constantine Spyropoulos, the defendants, were friends of Adrian Antoniu, who, based on the advice and information given by Antoniu, purchased and sold securities mostly in secret foreign accounts.

"a. From January of 1973 until February of 1975, Newman was employed as a securities trader and man-

ager of the over-the-counter trading department of Executive Securities Corp.

"b. From April of 1973 up to and including [3497] the date of this indictment, Carniol was living in Europe, principally in Brussels, Belgium.

"c. From September of 1975 up to and including the date of the filing of this indictment, Spyropoulos, a citizen of Greece, was also living in Europe, principally in France and Greece."

I will interrupt my reading at this point, ladies and gentlemen, to simply say that I am reading to you the charges set forth by the grand jury in the indictment. Of course, you have not heard proof of some of the allegations in the indictment as returned by the grand jury, but I am reading the indictment to you in full nonetheless. You will be fully aware of the charges made against Mr. Newman and the proof adduced against him. Resuming the reading:

"5. At various times relevant to this indictment, all of the bidding companies listed below were publicly-held companies or subsidiaries of publicly held companies that initiated merger, acquisition, tender offer or other takeover bids for, and/or entered into discussions and negotiations regarding the merger with or acquisition of, the publicly-held target companies listed below."

And then the indictment lists a series of [3498] bidding companies and target companies and you will see them when you read the indictment. I will simply read the bidding company followed by the target company.

"Ciba-Geigy Corporation, bidding company; Funk Seeds International Inc., target company.

"North American Philips Development Corporation, bidding company; Magnavox, target.

"Standard Oil Company of Indiana, bidding; Occidental Petroleum Corporation, target.

"Societe Imetal, bidding; Copperweld Corporation, target.

"Times Mirror Company, bidding; Hudson Pulp & Paper Corporation, target.

"Hanson Industries Inc., bidding; Hygrade Food Products Corporation, target.

"Societe Nationale des Petroles d' Aquitaine, bidding; Ventron, target.

"Marathon Energy Company, bidding; Pan Ocean Oil Inc., target.

"Chemische Werke Huls AG, bidding; Robintech, target.

"Sandoz Seed Company, bidding; Northrup King & Co., target.

"Warner Lambert Company, bidding; Deseret [3499] Pharmaceutical Company Inc., target.

"Tenneco Inc., bidding; Monroe Auto, target.

"Standard Chartered Bank Limited, bidding; BanCal Tri-State Corporation, target.

"Anderson, Clayton & Co., bidding; Gerber Products Company, target."

"6. At various times relevant to this indictment and prior to the public announcement of significant events and facts concerning the above-mentioned takeover bids and negotiations, at least one of the companies involved in each bid or negotiation was represented by either Morgan Stanley or Kuhn, Loeb. Morgan Stanley represented Ciba-Geigy Corporation, North American Philips Development Corporation, Standard Oil Company of Indiana, Tenneco Inc., Societe Nationale des Petroles d' Aquitaine, Pan Ocean Oil, Sandoz Seed Company, Werner Lambert Company, Standard Chartered Bank Limited, Anderson, Clayton & Co., and Kuhn, Loeb represented Societe Imetal, Hudson Pulp & Paper Corporation, Hanson Industries Inc., Robintech Company, Chemische Werke Huls AG, as well as a company called Great Basins Petroleum, which for a time in 1976 was seeking a buyer."

Continuing to read from the indictment:

[3500] "The conspiracy.

"7. From on or about January 1, 1973 to on or about December 31, 1978, in the Southern District of New York and elsewhere, E. Jacques Courtois, Jr., James Mitchell

Newman, also know as Barnett, Franklin Carniol and Constantine Spyropoulos, the defendants, unlawfully wilfully, and knowingly, did combine, conspire, confederate, and agree with Adrian Antoniu and other persons to the grand jury known and unknown to commit certain offenses against the United States, to wit: violations of Title 18, United States Code, Sections 1341 and 1343, and Title 15, United States Code, Section 78j(b) and 78ff, Rule 10b-5, 17 Code of Federal Regulations, Section 240.10b-5.

"8. It was a part of the conspiracy that E. Jacques Courtois, Jr., James Mitchell Newman, Franklin Carniol and Constantine Spyropoulos, the defendants, would and did devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses, representations, and promises as set forth more fully below and in Counts 2 through 14, and that to execute the scheme, they would and did use and cause the use of the mails, in violation of Title 18, United States Code, Section 1341, and interstate wires, in [3501] violation of Title 18, United States Code, Section 1343."

I will add at that point that the government has offered no proof of violation of the wire statute. They are concentrating their charge in this case, as Mr. Richards told you yesterday, upon violations of the mail fraud statute.

To resume the indictment:

"9. It was further a part of the conspiracy that E. Jacques Courtois, Jr., James Mitchell Newman, Franklin Carniol, and Constantine Spyropoulos, the defendants, would and did directly and indirectly, and by use of means and instrumentalities of foreign and interstate commerce, the mails, and the facilities of national securities exchanges, (a) employ devices, schemes, and artifices to defraud and (b) engage in acts, practices and courses of business in connection with the purchase and sale of securities as more fully set forth below and in Counts 16

through 27, which operated as a fraud and deceit on Morgan Stanley, Kuhn, Loeb, and those corporations and shareholders on whose behalf Morgan Stanley or Kuhn, Loeb was acting and to whom Morgan Stanley or Kuhn, Loeb owed fiduciary duties, in violation of Title 15, United States Code, Section 78j(b) and 78ff, and Rule 10b-5.

[3502] "Objects of the conspiracy.

"10. Among the objects of the conspiracy were the following:

(a) As part of the conspiracy, the defendants agreed that Courtois would misappropriate confidential, material information concerning mergers and acquisitions and the companies involved in merger and acquisition discussions and negotiations, which information was entrusted to Morgan Stanley by its clients. They agreed further that Courtois would covertly relay such information to Antoniu and that Antoniu would, in turn, cause Newman, Carniol and/or Spyropoulos, whose names were not given to Courtois, to purchase the securities of the companies that were the targets of the confidential merger and acquisition discussions and negotiations. In so doing, Courtois and his co-conspirators would and did breach the trust and confidence placed in Morgan Stanley by its clients and the trust and confidence placed in Courtois by Morgan Stanley, its clients and the shareholders of its clients.

(b) As part of the conspiracy, the defendants agreed that Antoniu would misappropriate confidential, material information concerning mergers and acquisitions and the companies involved in merger [3503] and acquisition discussions and negotiations, which information was entrusted to Morgan Stanley and Kuhn, Loeb by their clients. They agreed further that Antoniu would advise Newman, Carniol and/or Spyropoulos, sometimes hereafter referred to as the buyers, to purchase the securities of the companies that were the targets of the confidential merger and acquisition discussions and negotiations. In

so doing, Antoniu and the conspirators would and did breach the trust and confidence placed in Morgan Stanley and Kuhn, Loeb by their clients and the trust and confidence placed in Antoniu by Morgan Stanley, Kuhn, Loeb, their clients and the shareholders of their clients.

[3504] (c) As part of their participation in the conspiracy, Courtois and Antoniu affirmatively misled Morgan Stanley and Kuhn, Loeb by, among other things, falsely and fraudulently promising to honor their fiduciary duties to maintain the confidentiality of material, confidential information provided to them in trust and confidence by their employers and their employers' clients, by intentionally and methodically violating those fiduciary duties, by falsely and fraudulently concealing the violation of their fiduciary duties, by failing to report the buyers' trading to their employers as required, and by falsely and fraudulently asserting that they maintained no direct or indirect interest in securities trading accounts. In so doing, Courtois and Antoniu, with the aid and support of the other conspirators, violated and caused each other to violate the fiduciary duties of honesty, loyalty and silence which each owed directly or indirectly to Morgan Stanley, Kuhn, Loeb and their clients."

The indictment continues: (d) As part of their participation in the conspiracy and in reliance on Courtois' and Antoniu's breach of fiduciary duties, Newman, Carniol and Spyropoulos received covert information and advice from Antoniu and through Antoniu [3505] from Courtois. Based on that information and advice, Newman, Carniol and Spyropoulos opened and maintained secret foreign accounts and purchased target companies' securities through those secret foreign accounts. In so doing, and by sharing profits from the sale of those securities with Courtois and Antoniu, Newman, Carniol and Spyropoulos aided, participated in and facilitated Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn, Loeb, and clients of those investment banks."

The grand jury in the indictment then lists what it charges to be the means of the conspiracy. Please remember, everything that I have been reading to you most recently comes from the indictment, which is a charge and not evidence.

"11. The means employed by the defendants and their co-conspirators to execute their conspiracy and carry out the unlawful objects set forth above were the following:

"a. In or about the latter part of 1973, James Mitchell Newman and Adrian Antoniu agreed that Antoniu, as a Morgan Stanley associate entrusted with access to information about impending or proposed [3506] mergers and acquisitions, would and did use his position to misappropriate such confidential information by leaking to Newman, among other things, the names of the companies targeted for acquisition or merger. Newman, in turn, would and did purchase the securities of target companies before public announcements of such merger and acquisition plans, information about which had been secretly provided to him by Antoniu. It was understood and expected that, after the public announcement, when the price of each stock rose, Newman would sell the securities and covertly share with Antoniu half of all profits realized and cover half of any losses incurred through the scheme.

"b. Shortly after making this arrangement with Newman, Antoniu agreed with Carniol and Spyropoulos to follow trading and profit sharing arrangements similar to those already described a subparagraph (a) herein.

"c. As part of his arrangements with each of his buyers, Antoniu misappropriated and leaked confidential information concerning merger and acquisition bids for a number of companies, including Funk Seeds International, Inc., Magnavox Co., Occidental Petroleum Corp., Copperweld Corp., Hudson Pulp & Paper [3507] Corp. and Hygrade Food Products Corp. to Newman, Carniol and Spyropoulos.

"d. Not long after the birth of this conspiracy, and in order to carry out their individual roles in it, Newman, Carniol and Spyropoulos each opened or caused to be opened secret foreign bank accounts. Through these bank accounts each of the buyers was able to secretly place orders for the purchase and sale of securities without having his name or the names of Courtois or Antoniu appear on brokerage or stock exchange records. To this end, Newman traded in the name of trust accounts in the Bahamas in Bermuda; Carniol traded through bank accounts in Luxembourg protected by that country's bank secrecy laws; and Spyropoulos traded in similar accounts in Switzerland protected by that country's bank secrecy laws.

"e. In late 1975, the defendant Courtois joined the conspiracy, agreeing to use his position to misappropriate and leak to Antoniu the confidential, material information he obtained as a trusted member of Morgan Stanley's merger and acquisition department regarding impending or proposed merger and acquisition bids and the companies involved in such bids.

"f. As a result of this arrangement and, [3508] with the understanding that Antoniu would conceal Courtois' identity even from Newman, Carniol and Spyropoulos, Courtois leaked to Antoniu, among others things, the names of target companies, including but not limited to Ventron Corp., Pan Ocean Oil, Inc., Northrup King & Co., Deseret Pharmaceutical Company Inc., Monroe Auto Equipment Co., BanCal Tri-State Corp., Gerber Products Company, Inc. Antoniu, in turn, passed those company names to Newman, Spyropoulos, who bought or caused to be bought, mostly in secret accounts, the securities of those companies.

"g. It was agreed and understood by and between the conspirators that Courtois and Antoniu would each receive one-third of all profits and share in one-third of any losses realized upon the sale of all stocks purchased based upon Courtois' leaks of confidential information.

"h. Following Courtois' initiation into the conspiracy, Antoniu continued to leak to Newman, Carniol and Spyropoulos confidential information regarding facts and events in impending or proposed merger and acquisition transactions which he, Antoniu, received as a trusted employee of Kuhn, Loeb, including the names of the following target companies: Robintech Co." And [3509] that's it.

"i. It was agreed and understood by and between the conspirators that Antoniu would receive one-half of all profits and share in one-half of any losses realized as a result of transactions generated from his own leaks from Kuhn, Loeb.

"j. It was further agreed and understood by and between the conspirators that all of the conspirators would conceal their misappropriation of confidential information from Morgan Stanley, Kuhn, Loeb, their clients and their clients' shareholders by, among other things, avoiding any use of the names of Courtois and Antoniu or any other action that would reveal Courtois' and Antoniu's interest in Newman's, Carniol's and Spyropoulos' accounts, by making any and all payments in cash or through secret bank accounts, by avoiding meetings with or between or telephone calls to Courtois or Antoniu at Morgan Stanley or Kuhn, Loeb, by the occasional use of aliases to conceal their true identity when leaving messages, by the use of foreign secret accounts, by attempting to use multiple foreign banks and/or multiple brokers to execute their trades, and by making false and misleading statements, when necessary, to any governmental or stock exchange [3510] personnel who should inquire about any of the conspirators' securities trading activity." Unquote from that part of the indictment. This is me again.

What must the government prove to sustain this charge of conspiracy? In order to convict Mr. Newman, the defendant on trial, of conspiracy, the proof must establish beyond a reasonable doubt, as I have defined that phrase, the following essential elements:

(1) the existence of the conspiracy charged in the indictment;

(2) that the defendant, Mr. Newman, knowingly and wilfully associated himself with the conspiracy; and,

(3) that one of the conspirators, not necessarily the defendant, knowingly committed at least one overt act within the Southern District of New York at about the time alleged and in furtherance of the conspiracy.

I shall refer a little later on to the question of overt acts, but let us now consider the first element, and that is the existence of the conspiracy itself.

The idea of a conspiracy is simple enough. A conspiracy is a combination, agreement or understanding [3511] of two or more persons to accomplish by concerted action a crime of unlawful purpose. The gist of the crime of conspiracy is the unlawful combination or agreement to violate the law.

The success or failure of the conspiracy is immaterial to the question of guilt or innocence of a conspirator. Thus, I instruct you, in order to convict a defendant of the crime of conspiracy, it is not necessary for you to find that the conspiracy was successful in all or even in any of its objectives. A conspiracy is basically an agreement to violate the law and may exist even though its final objectives were never accomplished.

However, while the government need not prove that the conspiracy was successful, proof concerning the accomplishment of some or all of the objects of the conspiracy may be the most persuasive evidence of the existence of the conspiracy itself. That is to say, success of the venture, if you believe it was partially or wholly successful, may be the best proof of the existence of the agreement.

To establish a conspiracy the government is not required to show that two or more persons sat around a table and entered into a solemn pact, orally or in [3512] writing, stating that they have formed a conspiracy to violate the law or the details or the means by which its objectives were to be achieved.

By its very nature a conspiracy is almost always characterized by secrecy, rendering detection difficult, and common sense will tell you that when persons in fact undertake to enter into a crime, conspiracy is frequently left to the unexpressed understanding. It is rare that a conspiracy can be proved by direct evidence.

What the evidence, either direct or circumstantial, must show in order to establish that a conspiracy existed is that two or more persons, in some way or manner, through any contrivance, impliedly or tacitly, came to a common understanding to violate the law or to accomplish an unlawful plan.

The period of time charged in the indictment runs from on or about January 1, 1973 to on or about December 31, 1978. But it is not necessary for the government to prove that the conspiracy started and ended on those specific dates. It is sufficient if in fact the conspiracy was formed and that it existed for some substantial time within the period set forth in the indictment and that at least one overt act was committed [3513] by any conspirator during that period.

In determining whether there has been an unlawful agreement or conspiracy, you may judge acts and conduct of the alleged conspirators that were done to carry out an apparent criminal purpose. The adage actions speak louder than words may be applicable here. Usually the only evidence available is that of disconnected acts and conduct on the part of the alleged individual co-conspirators, which acts and conduct, however, when taken together in connection with each other and considered as a whole, may permit an inference that a conspiracy existed as conclusively as by direct proof.

In considering this first element, the existence of the conspiracy, you must consider all the evidence which has been admitted with respect to the conduct, acts and declarations of each alleged co-conspirator and such inference as may reasonably drawn therefrom.

It is sufficient to establish the existence of the conspiracy if from the proof of all the facts and circumstances you find beyond a reasonable doubt that the minds of at least two alleged co-conspirators met in an understanding way to accomplish by the means alleged [3514] one or more of the objects of the conspiracy as charged in the indictment and as I have just read it to you.

I have already instructed you that in order to sustain its burden of proof on the conspiracy count the government need not prove an actual violation of the substantive counts which the defendant is alleged to have conspired with others to violate. Those substantive counts in this case, you will remember, charge the defendant with violations of the federal mail fraud statute and the federal securities laws statute.

However, although it is not necessary in a conspiracy charge for the government to prove an actual violation of any substantive statute, in determining whether or not the prosecution has proven beyond a reasonable doubt that Mr. Newman conspired to violate the mail fraud and/or securities fraud statute as charged or that there was such a conspiracy at all, you must consider the alleged conspiracy to violate the mail fraud statute separately and independently from the alleged conspiracy to violate the securities fraud statute. In other words, you may not find that there was a conspiracy to violate—let me start again. In other words, you may not find a violation of the conspiracy statute unless all 12 jurors agree as to the [3515] substantive offense or offenses that was the object of the conspiracy.

Thus, for example, you may not conclude that the prosecution has established a conspiracy if only six of you believe that the only object was to violate the mail fraud statute and the other six of you believe that the only object was to violate the securities fraud statute. You must be unanimous as to the object or objects of the conspiracy. You need not find that a violation of both substantive statutes was the object, although you may so

find, but you must agree unanimously that the violation of at least one of these particular statutes constituted an objective of the conspiracy.

If you are satisfied that the conspiracy charged existed, then you must ask yourselves whether the second element has been proved, merely, was the defendant, Mr. Newman, a member of that conspiracy? In determining that issue you should consider whether on all the evidence knowingly and wilfully entered the conspiracy.

An act is done knowingly if done voluntarily and intentionally, and not because of mistake, inadvertence, negligence or other innocent reason. An act is done wilfully if done voluntarily and [3516] intentionally, and with a specific intent to do something which the law forbids, with a bad purpose either to disobey or disregard the law.

However, wilfully does not mean that the defendant must have been aware that a specific federal statute prohibited the conduct which was the object of the conspiracy. In criminal cases it is not necessary to show that the defendant knew that he was breaking any particular law.

To find that the defendant became a member of the conspiracy, you must be convinced beyond a reasonable doubt that he was aware of the existence and at least some of the unlawful purposes of the conspiracy and willingly participated, with the intent to advance those unlawful purposes.

To be convicted as a member of a conspiracy the defendant need not know every objective of the conspiracy, every detail of its operation or means employed to achieve the agreed upon illegal objectives, or even the identity of every co-conspirator. There must, however, be agreement on the essential nature of the plan and other kinds of illegal conduct in fact contemplated. In short, the conspirator must agree to and participate in a scheme which he knows to have an [3517] illegal objective.

But if the defendant had no knowledge of any illegal plan devised by others or if he neither intended nor

agreed to commit nor advance that kind of illegal conduct, then he cannot be found guilty of conspiracy.

In this connection I charge you that knowledge is personal. That is, the personal knowledge of one individual, even if shown to be a co-conspirator, cannot be imputed to another individual to establish that latter individual's complicity in the conspiracy.

Moreover, a conspiracy to commit a particular substantive offense cannot exist without at least two conspirators having the degree of criminal intent necessary for the substantive offense itself. And just as knowledge is personal, so is intent. That is, the requisite intent must be established as to the defendant individually, without regard to the intent of others.

Now let me say more about intent. Under our system of laws, individuals are not punished criminally for mere mistakes, mere negligence, mere carelessness or mere errors of judgment. They are punished only for intentional wrongdoing. The defendant here is not on trial for errors of judgment or mistakes or carelessness. Rather, he is on trial for criminal offenses, and an [3518] essential element of such offense is an evil or criminal intent, which it is incumbent upon the government to prove to your satisfaction and beyond a reasonable doubt before you will be warranted in returning a verdict of guilty.

This instruction applies not only to the conspiracy counts, but to the substantive counts as well, to which I will presently come.

Questions of a defendant's knowledge and intent are matters of inference. Science has not yet devised a way to permit us to enter into a person's mind and to know with exactitude what he knows or thinks or what he knew or was thinking. However, you do have before you the evidence of certain acts and conversations on the part of the defendant.

You must decide whether these acts and conversations, if you accept that evidence, taken in consideration with

other material in evidence, show beyond a reasonable doubt knowledge on the part of the defendant of the unlawful purpose of the conspiracy, as well as the defendant's participation in it.

It is not necessary that a defendant be fully informed as to details or the full scope of the conspiracy to justify an inference of knowledge on his [3519] part. Each member of a conspiracy may perform separate acts at different times and at different places. Some conspirators may play major roles while others may play minor roles.

A single act may be enough to draw one within the ambit of a conspiracy, where that act is such as to justify an inference of knowledge of the conspiracy and its unlawful purpose. However, mere knowledge of or acquiescence in the objects of a conspiracy is not sufficient. Something more is required, and that something more is generally described as a stake in the venture or its outcome. While a financial stake is not essential, if you find that the defendant had such an interest, that is a factor which may be considered by you in deciding whether or not he was a member of a conspiracy.

I want to add one word of caution. Mere association of a person with alleged conspirators in business or otherwise does not establish his participation in the conspiracy, providing, of course, you should find that a conspiracy did in fact exist, that being the first element. So, too, mere knowledge by a defendant of illegal acts on the part of members of a conspiracy is not sufficient to establish a particular [3520] defendant's membership in the conspiracy.

Before the inference may be drawn that a defendant was a member of a conspiracy, you must, as I have already instructed you, be satisfied from the evidence presented by the government that this particular defendant knowingly associated himself with the conspiracy, with the specific intent to aid in the accomplishment of its unlawful purpose.

In determining whether the defendant is a party to the conspiracy alleged in the indictment, the defendant is

entitled to individual consideration of the proof respecting him or the lack of such proof. Thus, in considering whether the defendant was a member of a conspiracy, you must do so independently of the acts of the other alleged co-conspirators.

Proof of a particular individual's participation must be substantial and not slight. You may not base a finding of an individual's participation in a conspiracy upon mere suspicion, conjecture, guesswork or surmise.

The defendant argues that he acted at all times in good faith. It is up to you to decide whether that is the case or not. If you decide that the defendant always acted in good faith, it is your duty to [3521] acquit him, not only on the conspiracy count, but on all counts. That is because however misleading or deceptive conduct may have been, the law is not violated if the defendant acted in good faith and held an honest belief that his actions were proper and not in furtherance of any criminal venture.

A defendant has no burden to establish the defense of good faith, however. The burden is on the government to prove criminal intent and consequent lack of good faith beyond a reasonable doubt.

You are not to speculate or conjecture on why other individuals you may have heard referred to in the evidence are not charged in this indictment or why, although charged in the indictment, they are not on trial before you. As I said before, guilt or innocence is personal. You are concerned only with the guilt or innocence of Mr. Newman and whether the government has sustained its burden as to him beyond a reasonable doubt.

However, if you have found the conspiracy to exist and the defendant to have participated knowingly and intentionally in it, the extent of his participation has no bearing on his guilt or innocence. Even if a conspirator participated in the conspiracy to a degree more limited than that of a co-conspirator, he is [3522] equally culpable, provided, of course, you find that he was in fact a conspirator.

When people enter into a conspiracy to accomplish an unlawful purpose, they may become agents for one another in carrying out the conspiracy. Hence, the acts and declarations of one knowingly made in the course of the conspiracy and in the furtherance of the common purpose are deemed to be the acts of all the other members of the conspiracy and all are responsible for such acts.

Accordingly, if you find in accordance with these instructions that the conspiracy alleged in the indictment existed, then the acts, statements and the declarations made in furtherance of the conspiracy by a person found by you to have been a member of it may be considered against the defendant if you have also found that he was also a member, even though he was not present when such statements were made and even though such acts or statements or declarations may have taken place and have been made prior to his entry into the conspiracy and even though such acts and statements and declarations were made in his absence or without his knowledge.

It is important to note that this principle [3523] applies only to acts and declarations done or made during the course of the conspiracy and in furtherance thereof, that is, to carry out an unlawful objective or purpose of the conspiracy. It does not apply to acts or declarations which do not have these characteristics.

So, these are the first two elements of the conspiracy charge. First, was there a conspiracy, and, second, was the defendant a member of the conspiracy, if a conspiracy existed. These elements require findings of fact, and these are the sort of findings which you must make on all the evidence.

I mentioned earlier that the third essential element of the crime of conspiracy is that an overt act intended to effect the object of the conspiracy must be committed by at least one of the conspirators after the unlawful agreement has been made.

An overt act is any step, action or conduct which is taken to achieve, accomplish or further the objective of

the conspiracy. The purpose of requiring proof of an overt act is that while parties may conspire and agree to violate the law, yet they may change their minds and do nothing to carry it into effect, in which event their mere agreement, standing alone, will not constitute a crime. Hence, the necessity in law for an [3524] overt act.

An overt act need be neither a criminal act nor the crime which is the object of the conspiracy. In this case the indictment charges several overt acts, which I will read to you from the indictment, and you will notice as I read the overt acts charged in the indictment that you have heard evidence of some of them but not evidence of others. I resume my reading from the indictment:

"In furtherance of the conspiracy and to effect its objects, the following overt acts, among others, were committed in the Southern District of New York and elsewhere:

"1. In or about the first half of 1973 James Newman and Adrian Antoniu had a series of conversations in New York City.

"2. In or about the latter part of 1973 Constantine Spyropoulos and Adrian Antoniu had a conversation in Manhattan.

"3. In or about September, 1974 Franklin Carniol and Adrian Antoniu had a meeting in Brussels, Belgium.

"4. In or about the late winter or spring of 1975 E. Jacques Courtois, Jr. and Adrian Antoniu had [3525] several conversations in Manhattan.

"5. On or about May 17, 1975 Franklin Carniol and Adrian Antoniu had a meeting in Manhattan.

"6. On or about August 7, 1975 Franklin Carniol had a telephone conversation with Adrian Antoniu in Manhattan.

"7. On or about August 8, 1975 Franklin Carniol had a telephone conversation with Adrian Antoniu who was in Manhattan.

"8. On or about August 13, 1975 Franklin Carniol had a telephone conversation with Adrian Antoniu who was in Manhattan.

"9. In or about August of 1975 E. Jacques Courtois gave two United States treasury bills to Antoniu in Manhattan, Antoniu passed those two treasury bills on to Newman, and Newman deposited them in a Manhattan bank.

"10. In or about late autumn or early winter 1975, Adrian Antoniu met with E. Jacques Courtois, Jr. in Manhattan.

"11. On or about December 9, 1975, in Manhattan James Newman gave false testimony in a deposition concerning the bankruptcy of a brokerage house.

[3526] "12. On or about December 12, 1975 James Newman, in Manhattan, deposited two United States treasury bills.

"13. On or about April 26, 1976 James Newman received three United States treasury bills in Manhattan.

"14. On or about April 28, 1976 James Newman received one United States treasury bill in Manhattan.

"15. On or about May 10, 1976 James Newman, in Manhattan, deposited four United States treasury bills.

"16. On or about June 30, 1976, James Newman, in Manhattan, received two United States treasury bills.

"17. On or about August 31, 1976, James Newman, in Manhattan, received four United States treasury bills.

"18. On or about September 2, 1976 James Newman picked up two United States treasury bills in Manhattan.

"19. On or about October 18, 1976, James Newman, in Manhattan received eight United States treasury bills.

"20. On or about November 10, 1976, James Newman, in Manhattan received two United States treasury bills.

[3527] "21. On or about November 30, 1976 E. Jacques Courtois made a telephone call to Antoniu who was in Manhattan and who, in turn, contacted James Newman and Franklin Carniol.

"22. On or about January 21, 1977 James Newman made seven telephone calls from Florida to Bermuda.

"23. On or about January 24, 1977 James Newman made two telephone calls to Antoniu, who was in Manhattan.

"24. On or about January 26, 1977 James Newman made a telephone call to Antoniu, who was in Manhattan.

"25. On or about February 7, 1977 James Newman made three telephone calls to Antoniu, who was in Manhattan.

"26. On or about March 29, 1977 James Newman made a telephone call from Florida to Bermuda.

"27. On or about March 30, 1977 James Newman made two telephone calls from Florida to Bermuda.

"28. On or about March 31, 1977 James Newman made two telephone calls from Florida to Bermuda.

"29. On or about April 1, 1977 James Newman made three telephone calls from Florida to Bermuda.

[3528] "30. On or about April 7, 1977 James Newman made a telephone call from Florida to Bermuda.

"31. On or about November 11, 1977 Franklin Carniol caused funds to be transferred from Brussels, Belgium to an account in New York.

"32. On or about November 15, 1977 Franklin Carniol caused funds to be transferred from Brussels, Belgium to an account in New York."

I am not going to read you the next few overt acts. They do not involve individuals as to whom you heard evidence.

"36. In or about August of 1978 E. Jacques Courtois, Jr. and Antoniu met in Manhattan.

"37. In or about September of 1978 Franklin Carniol and Adrian Antoniu met in London, England."

End of reading from the overt acts as listed in the indictment. The important thing to understand, of course, about these overt acts is that some of them, indeed nearly all of them, are entirely innocent on their face. It is not illegal to call someone on the telephone or pick up a treasury bill and deposit it or receive it back again or to sell or purchase stock. These matters standing in and of themselves are not illegal at all.

[3529] But the government charges that the purpose of these acts was to effect a criminal purpose. If you

so find, then these acts shed their innocent character and become overt acts to further the purpose of an illegal enterprise.

It is not necessary for the government to prove that each member of the conspiracy committed or participated in any particular overt act since, as I have said to you, the act of anyone done in furtherance of the conspiracy becomes the act of all members of the conspiracy.

Also, the government is not required to prove each of the overt acts alleged in the indictment. It is sufficient if it proves the commission of at least one of the overt acts in furtherance of the conspiracy. It is necessary that at least one overt act have occurred within the Southern District of New York, and I charge you in that regard that the Southern District of New York includes the Borough of Manhattan. The overt acts need not to have occurred at the precise time alleged in the indictment or at the precise place.

While in the indictment the government has alleged particular overt acts, you are not limited to these overt acts but may consider other overt acts if [3530] you find beyond a reasonable doubt that there were such overt acts and that they occurred in furtherance of the conspiracy charged in the indictment.

The government, as I have said, is required to prove only one overt act occurring within the Southern District of New York in furtherance of the conspiracy.

To recapitulate, then, on the charge of conspiracy, to convict the defendant the government must establish each of the following elements:

(1) the existence of the conspiracy charged in the indictment;

(2) that the defendant, James Newman, knowingly associated himself with that conspiracy; and,

(3) that one of the conspirators knowingly committed at least one overt act in the Southern District of New York in furtherance of and during the course of the conspiracy.

If the government has established each of these elements beyond a reasonable doubt, then you must convict the defendant of conspiracy. On the other hand, if the government has failed to prove any one of these elements beyond a reasonable doubt, then you must acquit the defendant of the crime of conspiracy.

[3531] I have now covered count 1, which is the conspiracy count. I will turn in a moment to the substantive counts, but you might like to take a brief stretch and break at this time. I know I would. Why don't we do that. We will take a brief recess.

(Recess.)

[3532] THE COURT: We turn then, ladies and gentlemen, from conspiracy to the substantive counts in the indictment, which begin with Count 2.

In the substantive counts the government charges defendant with violating certain provisions of the federal mail fraud and securities laws. These are also the laws which the defendant is charged in Count 1 with conspiring with others to violate, and I remind you that conspiracy is an entirely separate crime from the substative crimes which are the objectives of the conspiracy.

The indictment also charges Mr. Newman with aiding and abetting other persons in the violation of the federal mail fraud and securities laws. I will instruct you later in this charge concerning the concept of aiding and abetting. It sounds rather like the law of conspiracy, but actually aiding and abetting is different. More about this subject later on.

First then I will instruct you on the seven counts of the indictment which charge the defendant with violations of what we call the mail fraud statute. I will read to you the provisions of Title 18, United States Code, Section 1341, the mail fraud statute, but first let me say that you should not be concerned if you [3533] do not fully understand the statute after it is first read to you. I will go over it with you several times and outline for you the elements so that you will be sure to understand what the statute is.

In any event, the statute provides:

"Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by false or fraudulent pretenses, representations or promises, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or knowingly causes to be delivered by mail according to the direction thereon any such matter or thing, commits a crime."

The defendant is charged in seven counts with violating this statute. The indictment, which I remind you again is merely an accusation and is evidence of nothing, begins with an introductory paragraph to the substantive counts, which I will now read:

"The grand jury further charges:

"12. From on or about January 1, 1973 up to and including December 31, 1978, in the Southern District of New York and elsewhere, E. Jacques Courtois, [3534] Jr., James Mitchell Newman and Franklin Carniol, the defendants, did unlawfully, wilfully and knowingly devise and intend to devise a scheme and artifice to defraud and to obtain money by means of false and fraudulent pretenses, representations, and promises as alleged in paragraphs 1 through 11 above.

"13. On or about the dates set forth below, in the Southern District of New York, E. Jacques Courtois, Jr., James Mitchell Newman and Franklin Carniol, the defendants, as indicated below in the Defendants Charged column and with respect to the counts below in which their names are listed, unlawfully, wilfully and knowingly, for the purpose of executing said scheme and artifice and attempting to do so, did cause to be placed in post offices and authorized depositories for mail matter in New York City, and did cause to be delivered by the United States Postal Service according to the directions thereon, mail

matter and things addressed to various foreign banks and persons, as more particularly set forth below."

Then following this introductory paragraph, which you will see when you receive your copies of the indictment, you will also see columns setting forth the count number, the security purchased and approximate [3535] date of mailing, the matter or thing mailed, and the addressee.

Thus, for example, under Count 2, the indictment specifies that with respect to securities purchased of Ventron Corporation a confirmation was mailed on February 3, 1976, addressed to the Bank of N.T. Butterfield & Son, Ltd. And so on through the rest of the substantive counts under the mail fraud statute in which Mr. Newman is charged. I won't bother to read them all to you now. They will become perfectly apparent to you when you look at the indictment.

The next count in which he is charged, for example, is Count 3 in the indictment, and that refers to a purchase of Pan Ocean Oil stock and a mailing on March 31, 1976 of a confirmation of that purchase to the Bank of Bermuda, and that is the pattern which you will see is followed in setting out the details of each of the mail fraud counts in which Mr. Newman is involved in the indictment, and under the mail fraud part of the indictment Mr. Newman is in fact charged, as you will see, with respect to Counts 2, 3, 5, 7, 9, 11 and 13.

You will deduce that there were other counts in the indictment charging other people, but you will have nothing to do with that. You are concerned only [3536] with Mr. Newman and what he is charged with.

Resuming reading from the indictment:

"14. The allegations contained in all the preceding paragraphs of Count 1 of this indictment are repeated and realleged as though fully set force herein and as constituting and describing part of the scheme by which the defendants Courtois, Newman, Carniol and others committed the offenses charged in these counts," "these counts" being the mail fraud counts.

In order to find the defendant guilty of mail fraud under Counts 2, 3, 5, 7, 9, 11 and 13 the government must establish beyond a reasonable doubt the following three essential elements:

First, that there existed a scheme or artifice to defraud or to obtain money or property by false or fraudulent pretenses, representations or promises at or about the time alleged in the count;

Second, that the defendant Newman knowingly and wilfully helped devise or participated in the scheme or artifice to defraud with knowledge of its fraudulent nature and with the intent to defraud; and

Third, that the use of the mails in Counts, 2, 3, 5, 7, 9, 11 and 13 was for the purpose of executing such scheme or attempting to do so.

[3537] The first element of the offense is the existence of a scheme or artifice to defraud. The language describing this first element is almost self-explanatory.

A scheme or artifice is merely a plan for the accomplishment of an object. A scheme to defraud is any plan or design by which a person seeks to obtain money or property from another or to deprive another of a valuable right or interest or to gain an unfair advantage for himself at the expense of another. It is a term that embraces all possible means, however ingenious, clever or crafty, by which a person seeks to gain some unfair advantage over another person. And so a scheme to defraud is any plan or design by which a person seeks to obtain money or property from another, to deprive another of a valuable right or interest, or to gain an unfair advantage for himself.

The fraud condemned by the statute is not limited to active misrepresentation. It also includes false suggestion, suppression or concealment of the truth or breach of a known duty. Of course, affirmatively stating facts as true when the facts are not true may constitute a fraud.

A fraudulent scheme may also exist although [3538] no express representation of fact is made. Indeed, a state-

ment may be fraudulent if it omits or conceals material facts which makes what is said deliberately misleading.

The deceitful concealment of material facts may also constitute a fraud where there is a duty to speak the truth, as I will explain shortly, and the devising of a scheme to defraud by such omissions or such nondisclosures or concealments or by creating false impressions is in violation of the mail fraud statute.

In sum, if there is deception for a forbidden purpose, the manner in which that deception is accomplished is immaterial.

I turn now to the particular fraudulent scheme which the government charges in this case. The scheme which the government charges may be summarized in one sentence. It is this:

The government charges that trusted employees of Morgan Stanley & Company and Kuhn, Loeb, investment banks, misappropriated confidential, nonpublic, material information concerning potential corporate takeovers or acquisitions entrusted to the investment banks by their clients and, together with others acting in concert with them, used that information to trade in the stock market [3539] for the personal profit of the participants in the scheme, while at the same time concealing material facts concerning these activities from the investment banks who employed them and from the clients of those banks.

Let us examine the elements of this alleged scheme more closely. The employees of Morgan Stanley and Kuhn, Loeb, the investment banks involved, according to the government's theory, are Adrian Antoniu, while he was at Morgan Stanley and later at Kuhn, Loeb, and E. Jacques Courtois at Morgan Stanley. One of the other individuals the government charges was involved in the scheme is James Newman, the defendant in this trial.

The government charges that Antoniu and Courtois, while employed by the investment banks, misappropriated confidential, nonpublic, material information concerning potential corporate takeovers or acquisitions, that infor-

mation having been entrusted to the investment banks by their clients.

Some of these words are self-explanatory. To misappropriate means to take and use something without the authority of the rightful owner. It is the equivalent of steal.

Confidential information means what it says. It is information entrusted to others on the [3540] understanding it would not be further revealed.

Information is nonpublic if it is not generally available to the public through such sources as press releases, trade publications or word of mouth.

You have learned during the course of this trial what corporate takeovers or acquisitions are and I need not define those terms for you further.

As stated earlier, the government charges that the scheme involved, the misappropriation of confidential, nonpublic, material information. I will define the word "material" for you within the context of the purchase of stocks in the stock market, for that is the purpose for which the government charges the participants in this scheme were misappropriating nonpublic, confidential information from the investment banks and their clients.

Generally speaking, we use the word "material" to distinguish the kinds of statements or omissions we care about from those that are of no real importance. A material fact is one which would reasonably be expected to be of concern to a reasonable and prudent person in taking action of relevance to the issues in the case.

That means that even if you find that a particular statement of fact was untruthful, or a [3541] particular concealment or omission was fraudulent, you cannot find that the statement or omission was material unless you also find that the statement or omission was one that would have mattered to a reasonable person in making a decision or taking action relevant to this case.

The same principle applies to fraudulent omissions as to fraudulent statements. If you find that information was intentionally withheld or omitted which would, if

disclosed, have changed the nature of the information that was given, so that a reasonable person's action may well have been different, then the omission was material.

Now, this is a general definition of "material." Within the particular context of the purchase and sale of stocks, a fact is material if there is a substantial likelihood that a reasonable shareholder would consider the fact important in deciding whether to buy, sell or hold securities and at what price to buy and sell.

To establish materiality the government need not prove a substantial likelihood that disclosure of the omitted fact would have caused a reasonable investor to change his mind and refuse to sell. All that is required is that there be a showing of a substantial likelihood under all the circumstances that the omitted [3542] fact would have assumed actual significance in the deliberations of a reasonable shareholder.

Put another way, there must be substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of the information then available.

In essence, the information the government charges the participants in this scheme with misappropriating concerns the plans of one company to take over another, that other company being referred to as the target company, or the efforts of a company to arrange its own takeover or acquisition by another company, in which event it is seeking to make itself a target.

In each of the counts alleging violation of the mail fraud statute the government charges that the participants in the scheme, one of whom was Mr. Newman, wrongfully acquired and used such information concerning a particular corporate transaction.

In determining whether that information was material under the definition I have been discussing, you must consider the probability of a subsequent takeover bid as indictated by the information in question, [3543] the extent to which the probability of a takeover bid was also

revealed by other information already available to the public, and the anticipated importance of the event in the light of the totality of the target company's activities.

You have heard evidence from Mr. Antoniu that he gave Mr. Newman information concerning possible take-over bids and that thereafter Mr. Newman purchased stocks in the potential target companies. If you believe that evidence—and it is, of course, entirely up to you, as are all issues of fact—then in judging the question of materiality of the information, as I have defined that phrase, you may consider the fact that Mr. Newman bought the stocks in question after talking with Mr. Antoniu.

You may also consider on the question of materiality the market reaction to the public announcement, when it was finally made, of the information allegedly misappropriated by participants in the alleged scheme.

You will recall that the scheme charged by the government also includes the concealing of material facts by Antoniu and Courtois from the investment banks which employed them and the clients of those banks. [3544] This is a different context. Within this context I return to that general definition of a material fact which I gave to you earlier. That is, a material fact is one which would reasonably be expected to be of concern to a reasonable and prudent person in the circumstances presented by this case.

Here the government charges that Antoniu and Courtios concealed from the investment banks which employed them and from those banks' clients the fact that they were making use of confidential information for their own purposes. Assuming you find that such activities took place, you must consider whether the existence of such activities would have been material to the entities concerned, namely, the investment banks or their clients.

You will have observed that I have defined the word "material" for you in two different contexts. The first relates to the information which the government charges the participants in the scheme misappropriated. Accord-

ing to the government's theory, the sort of information which was intended to be kept confidential by the investment banks was information that was material in the stock market sense of the word.

Therefore, to sustain a conviction on any [3545] particular mail fraud count the government must prove, first, that the particular information misappropriated was material in that sense, and that Newman purchased the stock in question because of that information.

The government must also prove that such activities on the part of Antoniu and Courtois, if you find that they in fact occurred, would have been material to their investment bank employers and their employers' clients had they known of them.

You will recall that I defined the scheme to defraud as any plan or design by which a person seeks to obtain money or property from another, or to deprive another of a valuable right or interest, or to gain an unfair advantage for himself at the expense of another.

It is important that you understand the precise charges contained in this indictment. It is important that you understand who the parties the government says were the victims of the alleged fraudulent scheme.

Those victims, according to the government's charges, were Morgan Stanley, as employer of first Antoniu and then of Courtois, Kuhn, Loeb, as subsequent employer of Antoniu, and the companies which entrusted their confidential information to those investment banks.

[3546] The government does not charge in this case that the persons from whom Mr. Newman purchased stocks in the target company were themselves defrauded by Mr. Newman's nondisclosure of whatever confidential information you may find he obtained from Antoniu.

I instruct you as a matter of law that in the circumstances of this case Mr. Newman was under no duty to disclose such information to the persons from whom he was purchasing the stock of the target companies. This indictment charges that Mr. Newman and the other in-

dividuals referred to defrauded not the sellers of the target companies' stock, but rather Morgan Stanley, Kuhn, Loeb and their corporate clients.

A few minutes ago, while reading the conspiracy count, I read to you that portion of the indictment which charges that, as part of a conspiracy and the scheme to defraud alleged, the defendant Newman and his alleged coconspirators "aided, participated in and facilitated Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn, Loeb and clients of those investment banks."

I will now explain one of the major concepts embodied in the indictment, the concept of fiduciary [3547] duties.

There are really two fiduciary duties at issue in this case. The government charges that Courtois and Antoniu, with Mr. Newman's aid, breached the fiduciary duties which Courtois and Antoniu owed to their employers, Morgan Stanley and Kuhn, Loeb, and the fiduciary duties owed to the clients of those two investment banks and to their shareholders.

Fiduciary is derived from the Latin word fidus, which means faith. I instruct you that an investment banker, such as Antoniu or Courtois, owes a fiduciary duty to his employer and his employer's clients to act with the utmost good faith and loyalty toward the employer's clients, to maintain the confidentiality of the information imparted to his employer in confidence by the clients, to disclose to his employer any personal interest in or participation in the securities markets that would in any way injure, impair, interfere with or frustrate the business interests of the client in order to promote his own personal interests.

An investment banker, such as Courtois and Antoniu, has a duty not to act in any manner which is inconsistent with the client's interest. He has a duty [3548] to protect the confidential plans of and facts concerning those clients and not to secretly profit personally on or as a result of the misappropriation or revelation of those confidential plans and facts.

In this case the government contends that both Antoniu and Courtois breached those duties by revealing the basic plans of and facts about clients of Morgan Stanley and Kuhn, Loeb to Newman.

The government contends further that in order to continue the success of their scheme Courtois and Antoniu made affirmative misrepresentations to their employers and that they failed to disclose the scheme to their employers or their employers' clients.

The government further contends that by acting on the misappropriation of takeover information by Courtois and Antoniu, by buying the stock of various target companies, and by concealing Antoniu's and Courtois' interest in his securities accounts, Newman aided and abetted Antoniu and Courtois in these various alleged breaches of duties to their employers and to their employers' clients.

You must decide as to each stock listed in the mail fraud counts whether these allegations have been proven. [3549] I charge you that a breach of fiduciary duty standing alone does not constitute a fraud under this statute. To bring the breach of a fiduciary duty within the mail fraud statute the government must prove that some actual harm or injury was at least contemplated.

We are concerned in this case with individuals who owed fiduciary duties to others. The disclosure by a fiduciary of material information which he is under a duty not to disclose, under circumstances where the disclosure could or does result in harm to the one whom he owes his duty, constitutes fraud within the meaning of this statute.

Similarly, the concealment by a fiduciary of material information which he is under a duty to disclose to another, under circumstances where the nondisclosure could or does result in harm to that other, constitutes a fraud within the meaning of the statute.

You will have noticed that I use the phrase "under circumstances" where the schemers' acts "could or does result in harm" to the one to whom a fiduciary duty is

owed. That is because in order to establish the existence of a scheme to defraud the government need not show that the scheme's victims were in fact defrauded or that the participants in the scheme realized any gain at [3550] all from it. The statute strikes at schemes. You concentrate on whether or not there was such a scheme.

Thus, while you are free to take into account the fact that the scheme may have succeeded in whole or in part, if you find that to be the case, nevertheless it is not necessary for the government to prove that the scheme succeeded or that anyone was actually defrauded, but only that a criminal scheme, as I have defined it, was devised and employed.

Similarly, while you may take into account the fact that the scheme may have caused harm to Morgan Stanley, Kuhn, Loeb or its clients, if you find such to be the case, nevertheless the government need not prove that the scheme actually caused harm.

It is sufficient for the government to prove that, in the circumstances of the case, the scheme carried within it the potential of causing harm to others and that the participants in the scheme were aware of that potential.

In addition, it is not necessary in a mail fraud case based upon a breach of fiduciary duty by a private employee for the government to prove direct, tangible, economic loss to the victim, actual or contemplated.

[3551] The object of a fraudulent scheme need not be the deprivation of a tangible interest, such as money, from another. Schemes designed to deprive its victims of intangible rights also violate the mail fraud statute.

For the purposes of this case, I charge you that any employer, including investment banks, has the right to its employees' honest services and to have its business conducted honestly. An investment bank has the right to expect that its employees will not divulge information entrusted to its employees by clients in confidence.

An investment bank has an interest in preserving its reputation for being able to preserve confidential informa-

tion. The clients of an investment bank have the right to expect that their confidences will be respected and protected. And confidential information itself has a negative value which may be diminished when confidentiality is lost. A scheme which is intended to deprive another of these intangible rights or interests can constitute a scheme to defraud under the mail statute.

Everything I have been telling you thus far on these counts relates to the first element of the crime of fraud, that is, the existence of a fraudulent [3552] scheme.

The second essential element of the mail fraud counts which the government must prove beyond a reasonable doubt is that the particular defendant you are considering, James Newman, devised or participated in the fraudulent scheme knowingly, wilfully, and with a specific intent to defraud.

While you heard a good deal about Mr. Antoniu and Mr. Courtois, I remind you that only Mr. Newman is on trial before you, that guilt or innocence is personal, and that the government's burden in this trial is to prove the guilt of Mr. Newman beyond a reasonable doubt.

The words "devise" and "participate" are words that you are all familiar with and I need not spend too much time on them. To devise a scheme to defraud is to concoct or plan it. To participate in a scheme to defraud means to associate oneself with it with a view and intent to make it succeed.

While the mere onlooker is not a participant in a scheme to defraud, it is not necessary that a participant be someone who personally and visibly executes the scheme to defraud. If you find that the defendant played an essential role in putting the scheme together, that would be sufficient to show devising or [3553] participation.

Moreover, you are entitled to find that the defendant devised or participated in a fraudulent scheme if he knowingly and intentionally aided and abetted others by his actions and conduct in the promotion or execution of the fraudulent scheme.

As I said, more on the subject of aiding and abetting a little later on.

I have already explained to you what we mean by knowing and wilfully and how one proves knowledge. Those elements are also necessary here, and I have given you the definitions before.

Intent to defraud means merely that the defendant knew of the fraudulent nature of the scheme and intended to help it succeed. In other words, to act with an intent to defraud means to act knowingly and with the specific intent to deceive, ordinarily for the purpose of causing some loss to another or to bring about some gain to oneself.

It is not required that the government show that the defendant, in addition to knowing what he was doing and deliberately doing it, also knew that he was violating some particular federal statute. But the defendant must have acted with the intent to help carry [3554] out some essential step in the execution of the scheme to defraud alleged in the indictment.

In order to convict Mr. Newman of the mail fraud charges against him you must find beyond a reasonable doubt that he was aware that he was receiving information to which he was not entitled and, knowing that, he deliberately appropriated the information for his own use and the use of his alleged coschemers.

As I instructed you earlier, questions of knowledge, wilfulness and intent, like all other questions of fact, are solely for you to determine, and the state of a person's mind, while rarely susceptible of direct proof, may be established by circumstantial evidence.

Closely tied up with your consideration of defendant's knowledge and intent with respect to a scheme to defraud is the question of good faith. I touched on this subject in connection with conspiracy. I say it to you again now within the context of the mail fraud counts. You will recognize that good faith is necessarily a defense to the charges we are now considering, because if one acts

with genuine and true good faith one necessarily lacks an intent to defraud. But do not confuse genuine good faith, which is a [3555] defense, with the purposeful avoidance of learning the facts, which is not. For as I told you before, as you assess the defendant's state of mind in order to determine whether he acted wilfully or intentionally, the law is that a defendant cannot avoid criminal liability by deliberately closing his eyes to facts that one has a duty to see or by deliberately and consciously avoiding the discovery of the true facts of the matter.

A defendant, however, has no burden to establish the defense of good faith. As I have said to you, the burden is on the government to prove fraudulent intent and consequent lack of good faith beyond a reasonable doubt.

Conduct of a defendant may be considered in the light of other evidence in the case if it tends to prove an issue material to the charge. Thus, knowingly false exculpatory statements, in conjunction with all the other evidence, may be considered circumstantial evidence of fraudulent intent.

Here the government points to what it contends were knowing false statements and knowing concealments made by the defendant in a deposition conducted by the SIPC, you remember, in connection with the G. H. Sheppard brokerage house as bearing on the [3556] issue of intent under the fraud counts.

If you find that the defendant knowingly made false statements to SIPC or knowingly concealed relevant facts from it, you may, if you wish, infer from that fact a consciousness of guilt on the part of the defendant, that is, an attempt to cover up his criminal conduct by trying to mislead those who might discover and reveal his crime. On the other hand, you may not find that the defendant knowingly made false statements or omissions or you may not choose to draw such an inference. It is entirely for you to say.

In short, the character of every act depends on the circumstances in which it is done. It is for you as jurors to determine the character of the act in this case based on all the evidence.

I have said that in order to resolve the issues of Mr. Newman's knowledge and intent you will be required to make findings of fact concerning the operation of his mind. This will involve the drawing of reasonable inferences from the evidence you have heard.

While you have heard evidence of the activities of certain other individuals or entities in connection with the purchase of the stock of target companies before a public announcement of a takeover bid [3557] was made, I charge you that such activities by other individuals are quite irrelevant to the state of Mr. Newman's mind, unless there is a basis for you to find that he knew of those particular activities by others or of a general course of business conduct which those activities illustrate.

You have also heard evidence regarding the confidentiality rules and procedures instituted by Morgan Stanley and Kuhn, Loeb, the two investment banking institutions. I charge you that such rules and procedures are irrelevant to the state of Mr. Newman's mind, unless there is a basis for you to find that he knew of the existence and general nature of those rules and procedures. It is not necessary that the government prove Mr. Newman received copies of the written rules or that he was made aware of the precise wording in which those rules and procedures were cast. It is sufficient, as I have said, if the government shows that he was made aware of the existence and general nature of those rules and procedures.

In determining whether or not Mr. Newman acted wilfully and knowingly you may also consider other evidence, such as his knowledge of the marketplace in general, the evidence regarding his education at New [3558] York University School of Business Administration, as well as the evidence of Mr. Newman's coversations with Mr. Antoniu and with Mr. Bruce Steinberg.

Thus, on this element of the mail fraud counts you must review and put together all the circumstances in deciding whether or not it has been established beyond a reasonable doubt that the defendant, Mr. Newman, devised or participated in a scheme to defraud knowingly, wilfully, and with fraudulent intent.

Now, at this point of the charge I wish to instruct you particularly on the law of aiding and abetting. The aiding and abetting statute provides, in essence, that a defendant may be guilty of a crime even though he did not actually commit the crime himself.

In this case the government, as an alternative basis for its accusations against Mr. Newman, charges him under the aiding and abetting statute. The aiding and abetting statute, which appears in Section 2, Title 18, United States Code, provides:

"Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.

"Whoever wilfully causes an act to be done [3559] which if directly performed by him or another would be an offense against the United States is punishable as a principal."

This means that anyone who knowingly helps, aids or abets, procures or induces another to commit a crime is just as guilty of that offense as the person who actually commits it.

Under the aiding and abetting statute the defendant would be guilty if all the essential elements of the crime are shown even though he did not himself commit it if instead you find that he aided or abetted the commission of the offense or caused someone else to commit the offense or some of the elements of the offense.

You cannot find the defendant guilty as an aider and abettor unless you find that the offense was actually committed. That is what distinguishes an aider and abettor from a coconspirator, since in a conspiracy, as I have charged you, the actual commission of the substantive of-

fense is not necessary. It is necessary to demonstrate the actual commission of the substantive offense in order to find liability under the aiding and abetting statute.

Thus, you must find the defendant guilty if [3560] he aided and abetted the commission of the offense even if he was not the individual who played a principal part in the offense.

I charge you that mere knowledge on the part of a person that a crime is being committed is not sufficient to convict him as an aider and abettor. A mere spectator is not a participant and thus not an aider and abettor.

So too mere acquaintance with the principals without participation is not sufficient to constitute an individual an aider and abettor, nor is mere negative acquiescence in a criminal venture.

To decide whether a particular defendant aided and abetted the commission of a particular offense you should ask yourself these questions: Did he wilfully associate himself with the criminal venture? Did he wilfulliy participate in it as something he wanted to bring about even though he did not accomplish the criminal conduct in person? Did he knowingly and wilfully, by his own affirmative action, help to make that criminal enterprise succeed? If he did, then you may find that the person in question was an aider and abettor.

You are to consider the aiding and abetting [3561] statute in deciding whether or not Mr. Newman is guilty of the substantive charges I have described. Of course, if you conclude that Mr. Newman personally committed all the essential elements of the crime charged, then you need not consider the aiding and abetting statute, which only applies, as I have said, in situations where an individual aids or abets others in the commission of a crime.

If you find that the defendant knowingly and wilfully engaged in a scheme to defraud, or knowingly and intentionally aided and abetted others engaged in such a scheme, then you must consider the next element of the offense charged, that is, the final element, and it is whether

the mails were used in furtherance of the scheme. This is what we call the jurisdictional element, because the federal government only becomes involved in the prosecution of a fraud when there is some kind of interstate activity or where the use of the federal mails is involved.

Specifically, the mail fraud statute requires that in carrying out or attempting to carry out the fraudulent scheme some use be made of the United States mails, such as by mailing a letter or by taking actions that will cause someone else to mail a letter. The mail [3562] can be from one state to another or from one country to another or just within a state or even within a single city. It doesn't matter, as long as the United States mails are used.

Now, under Counts 2, 3, 5, 7, 9, 11 and 13 of the indictment the particular jurisdictional act that is charged is the mailing of a confirmation from the Southern District of New York. To satisfy this element as to each count you must find that the defendant caused the mailing listed in that count from the Southern District of New York, which includes Manhattan, on or about the dates set forth. However, you are not required to find that the defendant personaly mailed the item. Indeed, a defendant does not have to be directly connected with such a mailing or even know specifically it has occurred. Rather, it is sufficient if you find as to the defendant that he was reasonably likely to foresee that in the execution of the fraudulent scheme the confirmations listed in the indictment would be mailed, and therefore the defendant, in contemplation of law, caused the mailings.

Also please understand that in order for a mailing to be in furtherance of the fraudulent scheme you need not find the mailing itself was fraudulent. It [3563] is sufficient if you find that it occurred as one of the natural steps in the fulfillment of the scheme rather than being entirely incidental to or wholly without connection to the scheme.

Now, on this third element of the offense, as on the previous two, the government must carry its burden of proof beyond a reasonable doubt. To meet that standard it must prove, first, that the particular mailing occurred as charged in the particular count in question, and second, that such act was committed in execution of the fraudulent scheme that constitutes the first essential element of the offense, rather than merely coincidentally and without real relevance or connection to the alleged fraudulent scheme.

In this case the mailings which the government alleges satisfy this element are written confirmations of stock transactions mailed from the brokers in New York to the trusts in Bermuda. In accordance with the instructions I have just given you, the government must prove beyond a reasonable doubt that these confirmations were mailed for the purpose of executing the fraudulent scheme. It is not enough if these mailings were merely incidental to the scheme.

You will notice that in some of the counts, [3564] Counts 2, 5, 9, 11 and 13, the indictment specifies that more than one confirmation was mailed. However, with respect to each count the government is not required to prove that all of the confirmations listed were mailed. It is sufficient if you find that the government has proven beyond a reasonable doubt the mailing of at least one of the itemized confirmations in furtherance of the scheme to defraud. But you must be unanimous as to the particular mailing proved.

Nor is it required that the government show that the confirmations were mailed or received by any particular persons or that a particular person received documents or letters in stamped envelopes. Rather, use of the mails may be proved by evidence of business practice, custom or usage. Counts 2, 3, 5, 9, 11 and 13 each charge separate mailings.

To recapitulate then, the three elements which the government must establish beyond a reasonable doubt as to each of the mail fraud counts in the indictment are these:

First, that there existed a scheme or artifice to defraud or to obtain money by false or fraudulent pretenses, representations or promises at or about the time set forth in the count.

[3565] Second, that the defendant knowingly and wilfully helped devise or participated in the scheme or artifice to defraud with knowledge of its fraudulent nature and with the intent to defraud or that the defendant knowingly and intentionally aided and abetted or caused others to do so.

Three, that the use of the mails was involved in carrying out the scheme to defraud.

If you find that the government has proven each of these elements beyond a reasonable doubt with respect to the particular count you are considering, then you must convict the defendant on that count. If you find, however, that the government has not met its burden with respect to an element of mail fraud, then you must acquit the defendant on that count.

We come now to the remaining substantive counts in the indictment, Counts 15, 16, 18, 20, 22, 24 and 26. In these substantive counts, which name Mr. Newman, the government charges the defendant with violating certain provisions of the federal securities laws. These are also the securities laws which the defendant is charged in Count 1 with conspiring with others to violate, and I remind you again that conspiracy is an entirely separate crime from the [3566] substantive crimes which are the objectives of the conspiracy.

The indictment also charges the defendant with aiding and abetting other persons in the violation of the federal securities laws. I have just explained to you the concept of aiding and abetting and need not repeat it here.

The federal securities laws were enacted by Congress for many reasons, one of which was to achieve a high standard of business ethics in every facet of the securities industry. To this end, and mindful of the many schemes, devices and artifices which might be used as a means of

fraud in securities trading, Congress enacted the Securities Exchange Act of 1934. The Act bars all manners of fraudulent devices and contrivances which might undermine the integrity of the securities industry.

I will now read Title 15, United States Code, Section 78j(b), the antifraud provision of the Securities and Exchange Act of 1934. Section 78j(b) provides in pertinent part as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails [3567] or of any facility of any national securities exchange (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Securities and Exchange Commission may prescribe as necessary or appropriate in the public interest for the protection of investors."

Rule 10b-5, promulgated by the Securities and Exchange Commission under that statute, provides in pertinent part:

"It shall be unlawful for any person, directly or indirectly, by the use of any facility of any national securities exchange (1) to employ any device, scheme or artifice to defraud or (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security."

[3568] The prohibition with respect to a deceptive devise or contrivance is not confined to any particular kind of deception, as long as the statutory elements are proven. I will turn to those elements in a moment.

Turning to counts 15, 16, 18, 20, 22, 24 and 26 of this indictment, which I remind you again is merely an accusation and proof of nothing, the grand jury charges as follows, quote from the indictment:

"On or about the dates listed above, in the Southern District of New York and elsewhere, E. Jacques Courtois, Jr., James Mitchell Newman, and Franklin Carniol, the defendants, as indicated in the "Defendants Charged" column above and with respect to the counts in which their names are listed, unlawfully, wilfully and knowingly, by use of means and instrumentalities of interstate commerce, mails and the facilities of national securities exchanges, as alleged in paragraphs one through eleven above, did directly and indirectly, (a) employ devices, schemes and artifices to defraud and (b) engage in acts, practices, and courses of business which operated as a fraud and deceipt on Morgan Stanley, Kuhn, Loeb, and those corporations and shareholders on whose behalf Morgan Stanley or Kuhn, Loeb was acting, and to whom Morgan Stanley or Kuhn, Loeb owed fiduciary [3569] duties, in connection with the purchase of securities, including the following."

Then when you see it, you will notice that in the indictment there is just a column of information with respect to each of the indictments. Thus count 15 refers to the security purchased as Ventron Corporation, it gives the approximate dates of purchase as February 3 and 5, 1976, the number of shares as 500 and 200 and then lists Mr. Newman as one of the defendants charged. I will not give you all of the details on the remaining counts. They are all set up in the indictment the same way.

The indictment continues: "The allegations contained in all the preceding paragraphs of Count One of this Indictment are repeated and realleged as though fully set forth herein and as constituting and describing part of the scheme by which the defendants Courtois, Newman, Carniol and others committed the offenses charged in those counts." Unquote from the indictment.

In order to find the defendant guilty of securities fraud under counts 15, 16, 18, 20, 22, 24 and 26 the government must establish beyond a reasonable doubt the following four essential elements:

[3570] First, that the defendant, Mr. Newman, used or caused the use of means or instrumentalities of interstate commerce, the mails or a facility of a national securities exchange;

Second, that the defendant Newman employed any device, scheme or artifice to defraud or engaged in any act, practice or course of business which would or did act as a fraud or deceipt upon any person;

Third, that the defendant did so knowingly and wilfully;

Fourth, that this was done in connection with the purchase or sale of the securities specified in the indictment.

I will now discuss these elements in somewhat greater detail. In order to convict the defendant on these counts, you must first find beyond a reasonable doubt that he used means or instrumentalities of interstate commerce, the mails or a facility of a national securities exchange. The New York Stock Exchange and the American Stock Exchange are national securities exchanges. Thus, the phrase "facility of a national securities exchange" includes any facility of either the New York Stock Exchange or the American Stock Exchange.

[3571] Alternatively, in order to convict, you must find beyond a reasonable doubt that the defendant, Mr. Newman, used means or instrumentalities of interstate commerce or the mails.

I charge you that the government need not prove that the defendant personally used the facility of the New York or American stock exchanges or that he personally used means or instrumentalities of interstate commerce or the mails. It is enough if the government shows and if you find that the defendant by his personal acts, directly or indirectly, initiated the steps or aided, abetted, counseled or induced others to initiate steps which resulted in a chain of cause and effect resulting in the use of a facility of the New York Stock Exchange or the American Stock Exchange or means or instrumentalities of interstate commerce or the mails. This could mean something as simple as calling a stockbroker and placing an order to buy or sell a security.

The second element of the offense charged in the securities fraud counts requires you to find that the defendant, Mr. Newman, either employed a device or scheme to defraud or that he engaged in acts, practices or a course of conduct which would or did operate as a [3572] fraud and deceipt upon Morgan Stanley, Kuhn, Loeb or their clients.

I have already instructed you, in discussing the element of fraud required to be proved under the mail fraud counts, on the broad concepts of fraud or deceipt and devices or schemes to defraud. In those instructions I defined for you such terms as scheme or artifice, scheme to defraud and misappropriation. I told you that fraud could be found in both misstatements of fact and omissions of fact. I explained to you the fiduciary duties involved in this case and that a breach of a fiduciary duty without more does not constitute fraud, and I charged you on materiality in two contexts, the first relating to the information that the government alleges was misappropriated by the participants in the scheme, that is materiality in the stock market sense of the word, and the second relating to whether the government has proved that the activities charged in the indictment, if you find that they in fact occurred, would have been material to the investment banks and their clients, had they known of them. That is, a material fact is one which would reasonably be expected to be of concern to a reasonable and prudent person in the circumstances presented by this case.

[3573] My previous instructions on the element of fraud and all of its parts which I gave to you in connection with the mail fraud statute applie fully to these counts under the securities laws as well.

The second element may be satisfied by a finding that the defendant made an untrue statement of a material fact, omitted to state a material fact or aided and abetted others in doing so.

It is not a deceptive device in contravention of Rule 10b-5 for a person to use his superior financial or expert analysis or his educated guesses or predictions to determine what stocks to purchase or to sell. But here, as you know, the government contends that the scheme to defraud consisted primarily in the misappropriation by Antoniu and Courtois of material, nonpublic information, obtained in violation of a fiduciary duty and the subsequent use of that information by them and others acting in concert with them, including the defendant Mr. Newman, to trade in the stock market for the personal profit of the participants in the scheme, while at the same time concealing material facts concerning those activities from investment banks and their clients.

I remind you again that the fraud and [3574] deception charged in this case are said to be fraud and deceptions upon Morgan Stanley, Kuhn, Loeb and their clients. The indictment does not charge, nor does the government claim, that Mr. Newman took advantage of or deceived the people from whom he bought the stock. As I have said to you, the law is clear that Mr. Newman had no obligation or duty to the people from whom he bought the stock to disclose what he had learned, and, thus, he could not have defrauded these people as a matter of law. The charge is that others were defrauded.

It is not necessary for the government to establish that anyone relied on or suffered damage as a consequence of defendant's alleged failure to disclose material facts. Thus, if you find that the defendant was engaged in a scheme to misappropriate material, nonpublic information from Morgan Stanley, Kuhn, Loeb or their clients and to trade on that information, and if you find that in doing so the defendant, Mr. Newman, either made or aided and abetted others in making affirmative misrepresentations to Morgan Stanley, Kuhn, Loeb or their clients, or either concealed or aided and abetted others in concealing such conduct, and if you find that the misstated or omitted fact was material, then you may find that the second element is satisfied.

[3575] The second element may be satisfied by an alternative basis. If you find that the defendant intentionally engaged in any act, practice or course of conduct which would operate or did operate as a fraud or deceipt upon Morgan Stanley, Kuhn, Loeb or their clients, then you may consider this element to be satisfied.

The word "would" as in "would operate as a fraud or deceipt" is in the statute to show that the acts or practices need not have succeeded in defrauding anyone. It is sufficient to find that the acts or practices would have operated as a fraud or deceipt had they been permitted to run their full course.

To summarize the second element, then, let me reiterate. You must find that the defendant either employed any device, scheme or artifice to defraud or engaged in any act, practice or course of business which operated or would operate as a fraud or deceipt upon any person or aided or abetted others in doing either act.

I have defined for you the two subsections of Rule 10b-5 relevant here. In determining whether or not the prosecution has proven beyond a reasonable doubt that Mr. Newman violated Rule 10b-5 as to any count, you must consider each subsection separately. You may not find that Mr. Newman violated Rule 10b-5 on the [3576] particular count unless all 12 jurors agree as to the subsection violated. That is, you may not conclude that the prosecution has established a violation of Rule 10b-5 if some of you believe Mr. Newman violated one subsection and some of you believe he violated another subsection. You must be unanimous as to the subsection violated. You need not find that more than one has been violated, but you must agree as to which one, if any, was violated.

You have seen many documents in this case, including Morgan Stanley and Kuhn, Loeb personal memoranda, which purport to give interpretations of the securities laws then in existence. As I told you earlier in the trial, and I charge you again, you must not consider these documents as stating the law completely or accurately.

Those documents and interpretations of the law are not evidence of what the law is. They are merely evidence of what the Morgan Stanley and Kuhn, Loeb staffs were told. Similarly, the letter which attorney Neil Baron sent to Bruce Steinberg is not to be considered by you as an authoritative statement of the law. That letter is evidence only of what Baron said to Steinberg.

My instructions to you are the law which [3577] governs this case.

The third element of the offense charged in the substantive securities counts requires that you find the defendant to have acted knowingly and wilfully and with intent to defraud. I have previously defined those terms for you.

In determining whether a defendant has acted knowingly and wilfully, it is not necessary, as I have said, for the government to establish that the defendant knew he was breaking any particular law or in the securities context any particular rule. In the context of the securities laws, all that is necessary for this element to be satisfied is that the government establish a realization on the defendant's part that he was doing a wrongful act, assuming that you find that Newman's conduct was unlawful under the securities laws as I explained in the previous element, and that the knowing unlawful act involved a significant risk of effecting the violation that occurred.

An act is done knowingly if done voluntarily and intentionally, not because of a mistake or accident or other innocent reason. An act is done wilfully if done intentionally and deliberately. The word knowingly means that the defendant must be aware of what he was [3578] doing and what he was not doing. The word wilfully means that the defendant acted deliberately and with an evil purpose, that his acts, statements or omissions were not the result of innocent mistake, negligence or inadvertence or other innocent conduct.

I have reiterated and repeated certain of those definitions, but it seemed an appropriate thing to do at this point in the charge.

If you find that the government has proved each of the first three elements beyond a reasonable doubt, then you must go on to consider the fourth and final element, whether the scheme described in the indictment was in connection with the purchase or sale of the securities listed in the indictment.

It is sufficient for purposes of this element if you find that the deceptive practices, should you find that they in fact occurred, touched the purchase or sale of securities. In this case the government contends that the fraud not only touched the purchase or sale of the securities in defendant's accounts, but that the fraudulent scheme was directly related to the trading process.

To recapitulate, then, in order to sustain its burden of proof with respect to the offenses charged [3579] in counts 15, 16, 18, 20, 22, 24 and 26, the securities fraud statute, the government must prove beyond a reasonable doubt:

First, that the defendant Newman used means or instrumentalities of interstate commerce, a facility of a national securities exchange or the mails;

Second, that the defendant intentionally (a) employed any device or scheme to defraud or (b) engaged in any act or practice or course of conduct which would or did act as a fraud or deceipt upon any person or aided and abetted others so acting;

Third, that the defendant acted knowingly and wilfully; and,

Fourth, that the conduct was in connection with the purchase or sale of securities.

If you find that the defendant has proved each of these elements beyond a reasonable doubt with respect to a particular count, then your verdict will be guilty on that count. If you find that the government has not proved any of these elements beyond a reasonable doubt, then your verdict will be not guilty.

I am coming close to the end. I have concluded my charge on the counts of this indictment. I now turn to some additional points.

[3580] Adrian Antoniu has testified that he was a participant in the crimes charged in the indictment. If you accept that evidence as to his participation, then he may be characterized as an accomplice. Mr. Antoniu was permitted by the government to plead guilty to two charges arising out of the transactions set forth in this indictment. These plea agreements were entered into in exchange for Mr. Antoniu's agreement to cooperate with the government at this trial. He is currently awaiting sentence on the charges to which he has pleaded guilty.

In certain types of crime the government, of necessity, is compelled to rely upon the testimony of accomplices. Otherwise it would be difficult to detect and prosecute some wrongdoers. Often the government has no choice in the matter. It must take the witnesses and the transactions as they are.

There is no requirement in federal criminal law that the testimony of an accomplice be corroborated. It by no means follows that simply because an individual was an accomplice he is not capable of coming before you and giving a truthful version of events. Conviction may rest, then, upon the uncorroborated evidence of such an accomplice witness, if it is found credible by you as [3581] finders of the fact. Of course, the government contends in this case that it has, in addition, supplied corroboration from other evidence and the defendant denies that there is credible evidence of corroboration at all. The defendant also attacks, as you know, the credibility of Mr. Antoniu himself.

I do charge you, however, that the testimony of a witness who is an accomplice should be viewed with great caution and scrutinized carefully. That is particularly true where the witness has been permitted to plead to lesser or limited charges in consideration of his agreement to cooperate with the government.

It is for you to decide to what degree, if at all, Mr. Antoniu colored his testimony in hopes of a favorable recommendation by the government or for a lenient sentence. That is a question of credibility, and all questions of credibility are for you to decide.

I do stress that Mr. Antoniu's plea of guilty is personal to him and may, of course, in no way be considered as binding upon Mr. Newman or as furnishing any sort of evidence against Mr. Newman.

There is also evidence from which you may find that Mr. Antoniu has on prior occasions lied regarding certain facts about which he testified here. [3582] Again, this is a factor for you to consider and for you to decide whether you wish to accept the testimony of such a witness in whole or in part or reject it in whole or in part. You may decide, for example, that an admitted liar is unbelievable or, conversely, you may accept his testimony, recognizing that in life there are persons who have lied in the past but are not incapable of telling the truth in the present. Again, this is an issue of credibility. Again, it is for you.

You have heard evidence of certain statements made by the defendant. The government contends that those statements are inconsistent with defendant's position of innocence taken at trial. Statements inconsistent with a position taken at a trial are called admissions. Admissions by a defendant are among the most effectual proofs in the law and may constitute the strongest evidence against the defendant making them that can be given of the facts stated in the admissions. Accordingly, you are entitled to give great weight to the defendant's admissions in this case, if you find that the defendant made the statements in fact and, if he made them, if you find that in the circumstances they constitute admissions. Again, this is all for you. You are to give such statements such weight as you feel they [3583] deserve under all the circumstances.

There has been evidence that the defendant used trusts in foreign banks to effect transactions in the stocks listed

in the indictment. The use of trusts in the normal course of business whereby stock is held in one name for the beneficial ownership of another person violates no law. Similarly, the use of foreign accounts in the usual course of business violates no law. Indeed, neither practice is unusual.

But if you find that transactions were conducted in the name of trusts or through foreign accounts to conceal the true identity of persons engaged in the scheme or to cover up fraudulent devices, the use of trusts or foreign accounts sheds its normally innocent character and may be found by you to be an act in furtherance of an illegal purpose.

There is evidence that in 1973 and 1974 the defendant used a number of accounts at various broker-dealers to effect transactions in stocks. There is also evidence that the defendant made investment decisions in accounts which were in his mother's name. Such transactions, if you find they occurred, may be entirely innocent. If you find, however, that such accounts were being used by the defendant in order to [3584] conceal the identity of those making purchases of stock, then you may, although you need not, consider the fact as evidence from which to infer that the defendant acted wilfully and knowingly.

I have said in order to convict the defendant of any crime that you must find that he acted knowingly. That means in this case that the defendant must have had actual knowledge of fraudulent activities, such as the breach of a fiduciary duty not to misappropriate confidential information. However, where knowledge is an essential element, specific knowledge is not always necessary. I remind you that purposeful ignorance may be enough in determining whether a defendant acted knowingly. You may consider whether he deliberately closed his eyes to what otherwise would have been obvious to him.

If the government proves beyond a reasonable doubt that the defendant was aware of the high probability

that his acts were in furtherance of the criminal purpose, the government would have satisfied the burden of proving the defendant's guilty knowledge.

I also charge you, however, that guilty knowledge cannot be demonstrated simply by showing mere negligence or even foolishness on the part of the [3585] defendant, and you cannot draw the inference of guilty knowledge if you find that the defendant actually believed that no illegal conduct was involved.

I say to you again that although other individuals are named in the indictment and have been referred to during the trial, you jurors are concerned in this trial only with the guilt or innocence of Mr. Newman. Consequently, you must consider the evidence or lack of evidence concerning his acts within the framework and the context of the conspiracy laws, the substantive counts and the aiding and abetting statute as I have described them to you.

In considering whether or not a defendant acted in good faith, you are instructed that a belief by the defendant, if such a belief existed, that ultimately everything would work out all right so that no one would lose any money does not require a finding by you that he acted in good faith. No amount of honest belief on the part of a defendant that his venture will succeed in such a way that no one will lose would excuse false representations or other fraudulent actions by him which may subject others to the possibility of loss.

If a potential witness could have been called by the government or by the defendant and neither side [3586] called him, then you may infer that the testimony of the absent witness may have been unfavorable either to the government or the defendant. But, on the other hand, it is equally within your province to draw no inference at all from the failure of either side to call the witness. You should also bear in mind that there is no duty upon either side to call a witness whose testimony would be merely cumulative of testimony already in evidence.

In saying this I remind you that the defendant is not required to call any evidence at all or to establish his innocence. Rather, it is the government's duty to prove guilt beyond a reasonable doubt.

You have heard what we call expert witness testimony. I referred to a number of investment bankers who testified concerning the effect that public disclosure, if made, of the status of takeover negotiations at various times would have had upon the market prices of the stocks of certain companies. The general rule is that a witness is permitted to testify only as to facts and may not express his opinion. The exception to this rule is the opinion of a qualified expert on some particular technical matter.

The expert may testify to his opinion on a [3587] subject concerning which he has special knowledge. This is allowed on the theory that the advice of one who is experienced and versed in technical or special subjects will aid the jury.

You may consider the expert's qualifications and opinion, weigh his reasons, if any, and give his testimony such weight as you feel it deserves. As previously stated, expert opinion is purely advisory, and you may reject it entirely if in your judgment the reasons given for it are not convincing or sound. That determination rests with you and not with the experts.

The charts and summaries in evidence which you have seen, as I said, do not constitute evidence themselves. They are mere resumes, visual representations of information or data, as set forth in the testimony of witnesses or in documents that have been received in evidence. They are no better than the testimony or documents upon which they are based. It is for you to decide whether the charts, schedules or summaries correctly represent the data set forth in the testimony and any exhibits upon which they are based.

A final word on the substantive counts contained in the indictment. You will appreciate that these counts in essential part arise out of allegations [3588] of the same

facts and activities. But they find themselves in different counts because, as I have said to you, the same acts and activities, if proved by the government to have occurred and if the other elements are present, give rise to violations of separate federal statutes.

I also remind you that at the beginning of this charge I instructed you that the conspiracy count, which is count 1, is a separate and independent crime, apart from the substantive crimes upon which I have most recently charged you. Therefore, you may find the defendant guilty of conspiracy, even if the government has failed to prove his guilt of the substantive crime or crimes which were the objectives of the conspiracy.

And just to remind you of what I said about conspiracy which was sometime ago, the elements of a conspiracy, each of which the government must prove beyond a reasonable doubt, are: first, the existence of a conspiracy charged in the indictment; secondly, that the defendant knowingly associated himself with the conspiracy; and, third, that one of the conspirators knowingly committed at least one overt act in furtherance of the conspiracy.

I am not going to outline in detail the [3589] evidence and contentions upon which the parties rely. Counsel have summed up extensively and very ably, and to review the evidence would not be necessary.

The government relies upon the testimony of certain witnesses and documents and evidence in order to establish the crimes charged in the indictment.

The defendant challenges the government's case. He relies upon the presumption of innocence which is in his favor. I have already charged you on that presumption and its effects.

The defendant was under no obligation to put in any evidence. He was under no obligation to pursue or initiate any particular line of inquiry on cross examination of the government witnesses. He is entitled, as I say, to rely on his presumption of innocence.

The defendant also relies upon his attorney's cross examination of government witnesses. The defendant points to contradictions in the evidence offered by government witnesses which he perceives and the absence of evidence on certain points which he urges to be significant. He attacks the credibility of certain of the government's witnesses against him. He has offered evidence on his own behalf. He denies that the government's case has established guilt beyond a [3590] reasonable doubt as to any of the charges.

While the defendant did not testify in his behalf, I say again that in doing so he pursued his absolute right, and no adverse inference is to be drawn therefrom. It is the government's burden to prove the guilt of the defendant beyond a reasonable doubt. That burden remains with the government. It never shifts.

All evidence, whether or not I have referred to it or counsel has, is important and must be considered by you.

If by any chance I have made any reference to evidence which does not agree with your recollection, you are to disregard my references. You are to determine the facts on the basis of all the evidence, direct evidence, evidence elicited on cross examination, exhibits or the lack of evidence. For the government to prevail it must with respect to each count prove each of the essential requirements beyond a reasonable doubt, as already explained in these instructions. If it succeeds on a particular count, your verdict should be guilty and if it fails it should be not guilty.

You must, as I say, consider each count separately and render a separate verdict on each and every count. Your verdict in each case must be [3591] unanimous.

Under your oaths as jurors, you cannot allow a consideration of the sentence to be imposed upon the defendant if he is convicted to enter into your deliberations or to influence your verdict in any way. Your duty is to decide the case solely and only upon the evidence. In the event of conviction, the duty of imposing sentence rests

solely upon the Court, and you are not to be concerned with it.

Each juror is entitled to his or her own opinion, but each should exchange views with his or her fellow jurors. That is the very purpose of jury deliberation, to discuss and consider the evidence, to listen to the arguments of fellow jurors, to present your individual views, to consult with one another and to reach agreement based solely and wholly upon the evidence, if you can do so without violence to your own individual conscience.

Each of you must decide the case for himself or herself after consideration with his or her fellow jurors. But you should not hesitate to change an opinion which, after discussion with your fellow jurors, appears erroneous. However, if after carefully considering all the evidence and the arguments of your [3592] fellow jurors you entertain a conscientious view that differs from others, then you are not to yield your conviction simply because you are outnumbered or outweighed. Your final vote must reflect your conscientious conclusion as to how the issues should be decided.

Your verdict in this case will be announced at the end of your deliberations and in open court, and that verdict will take the form of separate findings of guilty or not guilty as to the defendant on each count.

It is your duty to agree on a verdict of guilty or not guilty on each count, if you can do so without violating your individual conscience.

I should advise you that if you have reached a unanimous verdict on any one or more counts, then you may report your verdict as you reach it or you may wait until you have reached a verdict on all counts, whichever you prefer. I do not suggest either procedure to you. I simply advise you of the options that you have.

Remember, though, that once you have reported a verdict in open court on one or more counts, then you may not change that verdict, even though you resume deliberations on other counts which you have not yet [3593] decided.

During your deliberations if you wish to hear any testimony or see or hear any exhibits or listen to any portions of this charge, send me a note through the foreperson of the jury. If you want to hear testimony, we will have the reporter read it back to you. If you send me such notes, please try to describe as specifically as you can what it is that you wish to hear or see. If you send me notes, please be sure not to tell me how you stand in your deliberations on any particular count. Your verdict may be announced only in open court, and that verdict, as I have said, must be unanimous.

The juror who sits in the number one chair will act as the foreperson of the jury, unless he prefers not to act in that capacity, in which case your first action will be to elect a new foreperson.

Ladies and gentlemen, that concludes my instructions. Thank you for listening so patiently. I will now confer with counsel in order to give them an opportunity before you begin your deliberations to object to any of the instruction I have given or to ask that any additional instructions be given.

If you will please return to your jury room, [3594] I will consider those matters with counsel and then we will call you out again. But you may now return to your jury room.

* * * *

[SEAL]

UNITED STATES DEPARTMENT OF JUSTICE

UNITED STATES ATTORNEY
SOUTHERN DISTRICT OF NEW YORK
One St. Andrew's Plaza
New York, New York 10007

Address Reply to
"United States Attorney"
And Refer to
Initials and Number
LBP:er

June 20, 1978

Maurice N. Nessen, Esq.
Kramer, Lowenstein, Nessen & Kamin
919 Third Avenue
New York, New York 10022

Re: *Bruce Steinberg*

Dear Mr. Nessen:

This Office is not presently possessed of information that Bruce Steinberg has committed a crime. However, based on the understandings specified below, Mr. Steinberg will not be prosecuted by this Office based on information supplied to this Office by him or for matters about which Mr. Steinberg may speak in answer to inquiries made by this Office or by a Grand Jury advised by this Office. Such immunity specifically includes possible criminal charges based on the use of inside information in connection with the purchase of securities.

The understandings are that Mr. Steinberg shall truthfully disclose all information with respect to the activities of himself and others concerning all matters about which

this Office inquires of him, and, further, shall truthfully testify before the Grand Jury and/or at any trial or other court proceeding with respect to any matters about which this Office may request his testimony.

It is further understood that Mr. Steinberg must at all times give complete, truthful and accurate information and testimony. Should it be judged by this Office that Mr. Steinberg has given false, incomplete or misleading testimony or information, or has otherwise violated any provision of this agreement, this agreement shall be null and void and Mr. Steinberg shall thereafter be subject to prosecution for any federal criminal violation of which this Office has knowledge, including, but not limited to, perjury and obstruction of justice. Any such prosecutions may be premised upon any information provided by Mr. Steinberg and such information may be used against him.

It is further understood that this agreement is limited to the United States Attorney's Office for the Southern District of New York, and cannot bind other federal, state or local authorities, although this Office will bring the cooperation of Mr. Steinberg to the attention of those authorities, if requested.

No additional promises, agreements and conditions have been entered into other than those set forth in this letter and none will be entered into unless in writing and signed by all parties.

Very truly yours,

ROBERT B. FISKE, JR.
United States Attorney

By: /s/ Lawrence B. Pedowitz
LAWRENCE B. PEDOWITZ
Assistant United States Attorney

APPROVED:

/s/ Frederick P. Hafetz
FREDERICK P. HAFETZ
Chief, Criminal Division

AGREED AND CONSENTED TO:

/s/ Bruce Steinberg
BRUCE STEINBERG

APPROVED:

/s/ Maurice N. Nessen, Esq.
MAURICE N. NESSEN, ESQ.
Attorney for Bruce Steinberg

[SEAL]

LSR:bg

U.S. DEPARTMENT OF JUSTICE

UNITED STATES ATTORNEY
SOUTHERN DISTRICT OF NEW YORK

One St. Andrew's Plaza
New York, New York 10007

April 15, 1981

Maurice Nessen, Esq.
Kramer, Levin, Nessen,
Kamin & Soll
919 Third Avenue
New York, New York 10022

Re: *Bruce Steinberg*

Dear Mr. Nessen:

Pursuant to our conversation of yesterday afternoon, this letter is to advise you that the statements and agreements made in our letter to you of June 20, 1978 remain, as far as this Office is concerned, in full force and effect.

Very truly yours,
JOHN S. MARTIN, JR.
United States Attorney

By: /s/ Lee S. Richards
LEE S. RICHARDS
Assistant United States Attorney
Telephone: (212) 791-1935

No. 82-1653

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

JAMES MITCHELL NEWMAN,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

SUPPLEMENTAL MEMORANDUM OF PETITIONER JAMES M. NEWMAN

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September 27, 1983

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1653

JAMES MITCHELL NEWMAN,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

SUPPLEMENTAL MEMORANDUM OF PETITIONER JAMES M. NEWMAN

In connection with the Court's consideration of the Petition for a Writ of Certiorari in the abovecaptioned matter, petitioner James M. Newman would like to inform the Court of the decision by the Court of Appeals for the Second Circuit of a related civil case. On September 9, 1983, the Second Circuit decided the case of *Moss v. Morgan Stanley Inc.*, No. 83-7120, a civil action brought against petitioner and others under, *inter alia*, Section 10(b) of the Securities Exchange Act of 1934 and S.E.C. Rule 10b-5.

Plaintiffs in *Moss* were persons with whom petitioner had no relationship but who sold securities on the open market at the same time petitioner was purchasing like securities while allegedly in possession of material nonpublic information regarding an impending tender offer for those securities. Petitioner allegedly obtained this information from employees of Morgan Stanley Inc., which was advising the potential bidder. These purchases by petitioner were among those used as evidence against him in the case now before the Court on petition for a writ of certiorari.

Relying on the Supreme Court's decisions in *Chiarella v. United States*, 445 U.S. 222 (1980), and *Dirks v. S.E.C.*, 51 U.S.L.W. 5123 (U.S. July 1, 1983), the Second Circuit affirmed the district court's dismissal of these actions against petitioner because petitioner "owed no duty of disclosure" to plaintiff. Slip op. at 16. Petitioner and the employees of Morgan Stanley were not "traditional 'corporate insiders'," and had not received any confidential information from the target. *Id.* Instead, "like Chiarella and Dirks, the defendants were 'complete stranger[s] who dealt with the sellers . . . only through impersonal market transactions'." *Id.*, citing *Chiarella*.

The Court of Appeals also rejected the "misappropriation" theory of Rule 10b-5 liability put forward by plaintiff. The court described plaintiff's argument as a theory "that any person who 'misappropriates' information owes a general duty of disclosure to the entire marketplace." *Id.* at 17. Citing the Supreme Court's decision in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), the court rejected this argument because "the Supreme Court has made clear that section 10(b) and rule 10b-5 protect investors against *fraud*; they do not remedy every instance of undesirable conduct involving securities." *Id.* at 18 (emphasis in original). And since the defendants "owed no duty of disclosure to plaintiff Moss, they committed no 'fraud' in purchasing shares of [the target

company's] stock." *Id.* The court concluded that "plaintiff's 'misappropriation' theory clearly contradicts the Supreme Court's holding in both *Chiarella* and *Dirks*," and therefore the complaint "fails to state a valid section 10(b) or rule 10b-5 cause of action." *Id.* at 19.

Respectfully submitted,

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Counsel for Petitioner
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Dated: September 27, 1983

No. 82-1653

In the Supreme Court of the United States

OCTOBER TERM, 1983

JAMES MITCHELL NEWMAN, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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Securities and Exchange Commission
Washington, D.C. 20549

QUESTIONS PRESENTED

Petitioner participated in a scheme in which employees of investment banking firms misappropriated confidential information concerning proposed mergers and acquisitions from the firms and their clients, secretly bought securities of the target companies on the basis of that material, nonpublic information, and subsequently sold those securities at a profit after the information had become public.

The questions presented are:

1. Whether petitioner's conviction for mail fraud should be reversed on the ground that the government did not show additional, tangible pecuniary damage to the firms or their clients.

2. Whether the scheme violated the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

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In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-1653

JAMES MITCHELL NEWMAN, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals affirming petitioner's conviction (Pet. App. 1a-3a) is unreported. The previous opinion of the court of appeals, reversing the dismissal of the indictment (Pet. App. 40a-54a), is reported at 664 F.2d 12. The opinion of the district court dismissing the indictment (Pet. App. 4a-39a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 8, 1983. The petition for a writ of certiorari was filed on April 8, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner was a securities trader. Two of his accomplices—E. Jacques Courtois and Adrian Antoniu—were employed by the investment banking firms Morgan, Stanley & Co., Inc., and Kuhn Loeb & Co. The clients of those

firms entrusted the firms with confidential information concerning prospective mergers, acquisitions, and tender offers.[1] From 1973 through 1978, Courtois and Antoniu misappropriated such information from their firms and surreptitiously relayed it to petitioner, who purchased securities on the basis of it. Two European residents, Franklin Carniol and Constantine Spyropoulos, were also part of the scheme. Following the announcement of the takeover plans, petitioner sold the securities at substantial profit and divided the gains with his accomplices. Pet. App. 41a-42a.

Petitioner and his accomplices adopted elaborate strategems to avoid being detected. The group made their purchases by cash or through secret foreign bank and trust accounts in order to avoid identification by brokerage or stock exchange records. They also used aliases when leaving telephone messages for each other at work, and they changed bank and trust accounts and spread their purchases among several brokers to avoid detection. Pet. App. 42a; J.A. 232, 239-241, 258-259, 275-279.[2]

Petitioner, Courtois, Carniol, and Spyropoulos were indicted in the United States District Court for the Southern District of New York on charges of mail fraud, in violation of 18 U.S.C. 1341; securities fraud, in violation of

---

[1] An investment banker is often retained in an advisory capacity by a corporation contemplating a tender offer or other form of acquisition. See M. Lipton & E. Steinberger, *Takeovers & Freezeouts* para. 1.4.2 (1978). Because of the sensitive (and often tentative) nature of the initial planning stage of a tender offer, the communications between an investment banker and its clients are highly confidential and the ability of an investment banker to protect clients' confidences is an important business asset. Particularly in the case of a proposed tender offer, the premature disclosure of that information or unusual market activity as a result of disclosure can adversely affect the ability of the client corporation to consummate the takeover at a favorable price. *Id.* at para. 1.6.

[2] "J.A." refers to the joint appendix filed in the court of appeals.

Sections 10(b) and 32 of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78ff, and Rule 10b-5, 17 C.F.R. 240.10b-5; and conspiracy to commit those offenses, in violation of 18 U.S.C. 371.[3] The indictment specifically alleged that petitioner and his accomplices agreed that the investment bank employees "would misappropriate confidential, material information concerning mergers and acquisitions and the companies involved in merger and acquisition discussions and negotiations, which information was entrusted to [the investment banking firms] by [their] clients" (Pet. App. 59a, 60a).

In this way, the indictment stated, petitioner and his accomplices breached and aided and abetted the "breach [of] the trust and confidence placed in [the investment banking firms] by [their] clients and the trust and confidence placed in" the firms' employees by the firms, the firms' clients and the clients' shareholders (Pet. App. 60a). The indictment further alleged that petitioner and his coconspirators "affirmatively misled [the investment banking firms] by, among other things, falsely and fraudulently promising to honor their fiduciary duties to maintain the confidentiality of [the] information provided to them in trust"; that they "falsely and fraudulently conceal[ed] the

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[3]Courtois, Carniol, and Spyropoulos are fugitives. Pet. App. 5a n.1. Antoniu pleaded guilty to a separate information and testified for the government against petitioner.

Petitioner suggests (Pet. 6 n.6) that the government acted improperly in not proceeding against Bruce Steinberg, a client of petitioner who also traded on the basis of the misappropriated information. But Steinberg's role in the scheme was wholly different from petitioner's. In contrast to petitioner, who engineered the fraud, Steinberg was not told of the source of petitioner's information and knew nothing of its fraudulent origin until the end of the scheme. See J.A. 440-461. The government accordingly promised Steinberg immunity at an early stage in the investigation (see J.A. 642-643) because it would otherwise have been unable to pursue the investigation of persons whom it believed to be more culpable.

violation of their fiduciary duties, by failing to report the * * * trading to their employers as required"; and that they "falsely and fraudulently assert[ed] that they maintained no direct or indirect interest in securities trading accounts." *Id.* at 60a-61a.

2. The district court dismissed the indictment. It held that the mail fraud counts could not stand because they were "unaccompanied by allegations or proof of direct, tangible, economic loss" to "the investment banks or their clients" (Pet. App. 37a). The district court further ruled that the interpretation of the securities laws was so unsettled that petitioner could not have had adequate notice that the conduct with which he was charged was illegal under those statutes (*id.* at 25a).

The government appealed the dismissal of the indictment, and the court of appeals reversed. In reinstating the mail fraud charges, the court of appeals held that the allegations of "fraudulent misappropriation of an employer's secret information" and of specific fraudulent acts and assertions by Courtois and Antoniu stated a violation of the mail fraud statute without an additional allegation of direct, tangible, economic loss to the victims of the fraud. Pet. App. 50a-51a. The court also ruled that, in any event, the mail fraud counts adequately alleged direct economic harm, noting that petitioner "could not have been unaware that confidential information, such as that involved here, has a 'negative' value which is diminished when confidentiality is lost." *Id.* at 52a.

The court of appeals also reinstated the securities fraud counts, reasoning (Pet. App. 47a; citations omitted):[4]

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[4]Senior District Judge Dumbauld, sitting by designation, described petitioner's actions as "reprehensible" and concurred in the court's decision on the mail fraud count, but he said that he was "not certain" that petitioner could be charged with securities fraud because the decisions of this Court "seem[ed] to evince a trend to confine the scope of §10(b) to practices harmful to participants in actual purchase-sale transactions." Pet. App. 53a.

> Had [petitioner] used similar deceptive practices to mulct Morgan Stanley and Kuhn Loeb of cash or securities, it could hardly be argued that those companies had not been defrauded. By sullying the reputations of Courtois' and Antoniu's employers as safe repositories of client confidences, [petitioner] and his cohorts defrauded those employers as surely as if they took their money.
>
> [Petitioner] and cohorts also wronged Morgan Stanley's and Kuhn Loeb's clients, whose takeover plans were keyed to target company stock prices fixed by market forces, not artificially inflated through purchases by purloiners of confidential information.

The court also noted that "since [petitioner's] sole purpose in participating in the misappropriation of confidential takeover information was to purchase shares of the target companies, we find little merit in his disavowal of a connection between the fraud and the purchase" (Pet. App. 48a).

On remand, petitioner was convicted on seven counts of mail fraud, seven counts of securities fraud, and one count of conspiracy. He received concurrent prison sentences of one year and one day on the conspiracy charge, on six mail fraud counts, and on six securities fraud counts. He was also sentenced to concurrent three year terms of probation on the other mail fraud and securities fraud counts and fined $10,000 on the conspiracy charge. J.A. 32. The court of appeals affirmed in a brief opinion. Pet. App. 1a-3a.

ARGUMENT

1. Petitioner's principal contention (Pet. 8-12) is that his mail fraud conviction must be reversed because the government did not show that the victims of his fraud suffered "actual or contemplated pecuniary injury" or "economic injury" (*id.* at 8). Petitioner does not explain what he means

by these terms, and the meaning of his contention is therefore somewhat difficult to discern. The district court specifically charged the jury that "a breach of fiduciary duty standing alone does not constitute a fraud under [the mail fraud] statute. To bring the breach of a fiduciary duty within the mail fraud statute the government must prove that some actual harm or injury was at least contemplated." Pet. App. 122a. Thus petitioner cannot claim that the government failed to prove that his fraud inflicted "actual or contemplated" injury on its victims.

Instead, petitioner's objection—although he does not say so explicitly—must be to the portion of the jury instructions that explained the kinds of economic harm or injury that would satisfy the statute. On this issue, the district court charged (Pet. App. 123a-124a):

> It is sufficient for the government to prove that, in the circumstances of the case, the scheme carried within it the potential of causing harm to others and the participants in the scheme were aware of that potential.
>
> In addition, it is not necessary in a mail fraud case based upon a breach of fiduciary duty by a private employee for the government to prove direct, tangible, economic loss to the victim, actual or contemplated. The object of a fraudulent scheme need not be the deprivation of a tangible interest, such as money, from another. Schemes designed to deprive [their] victims of intangible rights also violate the mail fraud statute.
>
> For the purposes of this case, I charge you that any employer, including investment banks, has the right to its employees' honest services and to have its business conducted honestly. An investment bank has the right to expect that its employees will not divulge information entrusted to its employees by clients in confidence.

> An investment bank has an interest in preserving its reputation for being able to preserve confidential information. The clients of an investment bank have the right to expect that their confidences will be respected and protected. And confidential information itself has a negative value which may be diminished when confidentiality is lost. A scheme which is intended to deprive another of these intangible rights or interests can constitute a scheme to defraud under the mail statute.

Accordingly, petitioner's assertion must be that the government must show tangible, quantifiable economic harm in order to obtain a mail fraud conviction.

This contention is wholly without merit. Nothing in the language of the mail fraud statute, 18 U.S.C. 1341, limits its coverage to fraud that inflicts tangible injury. On the contrary, the statute broadly applies to "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises * * *." This language obviously reaches the conduct of which petitioner was convicted.

Moreover, petitioner fails to cite a single case interpreting Section 1341 that adopts his view of the statute.[5] Petitioner

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[5]Petitioner quotes (Pet. 8) a phrase—"should be confined to pecuniary or property injury inflicted by a scheme to use the mails for the purpose"—from *Hammerschmidt* v. *United States*, 265 U.S. 182, 188-189 (1924). But that phrase referred not to the mail fraud statute itself but to a lower court decision applying that statute to an act of blackmail—an act that, unlike petitioner's, is not obviously "a[] scheme or artifice to *defraud*" (emphasis added). In fact, the *Hammerschmidt* Court approved the application of federal fraud statutes to "the deprivation of something of value by trick, deceit, chicane or overreaching * * * wronging one in his property rights by dishonest methods or schemes" (*id.* at 188)—terms that do not exclude intangible things of value or intangible "property rights," and that clearly describe what petitioner and his co-conspirators did to the investment banks and their clients.

acknowledges that courts have upheld mail fraud convictions even where the jury found only a breach of a fiduciary duty by the defendant without finding some additional quantifiable pecuniary harm, in cases involving both public officials (Pet. 10 n.11) and private employees (*id.* at 11 n.13). In fact, the courts of appeals have repeatedly upheld the application of the mail fraud statute to breaches of fiduciary duty like that aided and abetted by petitioner.[6] Petitioner's principal reliance (*id.* at 10-11) is on the Second Circuit's own decision in *United States* v. *Dixon*, 536 F.2d 1388 (1976). But *Dixon* specifically approved the application of the mail fraud statute to a "scheme contemplating pecuniary loss to someone *or* direct pecuniary gain to those who designed [the scheme]" (*id.* at 1399 (emphasis added); see *id.* at 1400) and to "a scheme to use a private fiduciary position to obtain direct pecuniary gain" (*id.* at 1399).

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[6]See, *e.g.*, *United States* v. *Greenleaf*, 692 F.2d 182, 188 (1st Cir. 1982), cert. denied, No. 82-1225 (Apr. 4, 1983); *United States* v. *Boffa*, 688 F.2d 919, 925-926 (3d Cir. 1982), cert. denied, No. 82-814 (Mar. 7, 1983); *United States* v. *Margiotta*, 688 F.2d 108, 121 (2d Cir. 1982), cert. denied, No. 82-1126 (May 2, 1983); *United States* v. *Barber*, 668 F.2d 778, 784 n.4 (4th Cir. 1982), cert. denied, No. 81-2166 (Oct. 4, 1982); *United States* v. *Bronston*, 658 F.2d 920, 926-928 (2d Cir. 1981), cert. denied, 456 U.S. 915 (1982); *United States* v. *Barta*, 635 F.2d 999, 1005-1007 (2d Cir. 1980), cert. denied, 450 U.S. 998 (1981); *United States* v. *Bohonus*, 628 F.2d 1167, 1170-1173 (9th Cir.), cert. denied, 447 U.S. 928 (1980); *United States* v. *Mandel*, 591 F.2d 1347, 1361-1364, vacated on other grounds, 602 F.2d 653 (4th Cir. 1979) (en banc), cert. denied, 445 U.S. 961 (1980); *United States* v. *Bush*, 522 F.2d 641, 646-648 (7th Cir. 1975), cert. denied, 424 U.S. 977 (1976); *United States* v. *Bryza*, 522 F.2d 414, 421-423 (7th Cir. 1975), cert. denied, 426 U.S. 912 (1976); *United States* v. *Isaacs*, 493 F.2d 1124, 1149-1150 (7th Cir.), cert. denied, 417 U.S. 976 (1974); *United States* v. *States*, 488 F.2d 761, 764-766 (8th Cir. 1973), cert. denied, 417 U.S. 909 (1974); *United States* v. *George*, 477 F.2d 508, 512-514 (7th Cir.), cert. denied, 414 U.S. 827 (1973). See also *United States* v. *Buckley*, 689 F.2d 893, 897-898 (9th Cir. 1982); *United States* v. *Drury*, 687 F.2d 63, 65 (5th Cir. 1982), petition for cert. pending, No. 82-1395; *United States* v. *Pintar*, 630 F.2d 1270, 1279-1280 (8th Cir. 1980).

2. a. Petitioner's sentences on the securities fraud counts are concurrent with his sentences on the mail fraud counts.[7] For that reason alone, the contentions he makes on the securities fraud issues do not warrant this Court's review. See *Andresen* v. *Maryland*, 427 U.S. 463, 469 n.4 (1976).

b. In any event, the claims petitioner makes with respect to his securities fraud convictions are without merit. Section 10(b) and Rule 10b-5 prohibit fraud in connection with the purchase or sale of securities. 15 U.S.C. 78j(b); 17 C.F.R. 240.10b-5. The Court has consistently construed this prohibition broadly. See, *e.g.*, *Herman & MacLean* v. *Huddleston*, No. 81-680 (Jan. 24, 1983), slip op. 10-11 (Section 10(b) should be construed so as to effectuate its "broad proscription against fraud"); *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972) ("These proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive."); *United States* v. *Naftalin*, 441 U.S. 768, 773, 775-777 (1979).

As the court of appeals explained (Pet. App. 46a-47a), petitioner's conduct was plainly fraudulent. "In other areas of the law, deceitful misappropriation of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, ha[s] consistently been held to be

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[7]In addition to his concurrent terms of imprisonment and probation, petitioner was also fined on the conspiracy charge. The conspiracy count charged both conspiracy to commit mail fraud and conspiracy to commit securities fraud. Pet. App. 58a-59a. But the mail fraud, securities fraud, and conspiracy charges were all based on the same "scheme and artifice." See *id.* at 73a, 78a. Thus the jury, in determining that petitioner was guilty of both conspiracy and mail fraud, necessarily found that petitioner engaged in a conspiracy to carry out a scheme that violated the mail fraud statute. For this reason, even if petitioner's securities fraud convictions were reversed, he would not be entitled to relief from his conspiracy conviction.

unlawful." *Id.* at 47a (citations omitted).[8] See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976) (brackets omitted) (Section 10(b) is "a 'catchall' clause to enable the Commission 'to deal with new manipulative or cunning devices' "). Indeed, petitioner does not appear seriously to deny the fraudulent character of his enterprise. He does not deny that he and his confederates misappropriated—"stole to put it bluntly" (*Chiarella* v. *United States*, 445 U.S. 222, 245 (1980) (Burger, C.J., dissenting))—confidential information in breach of a clear fiduciary duty owed to the investment banking firms and their clients. This Court's recent opinion in *Dirks* v. *SEC*, No. 82-276 (July 1, 1983), explicitly recognized the existence of this duty (slip op. 8 n.14)[9] and implicitly recognized that liability could be imposed for "misappropriat[ing] * * * information" (slip

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[8]In *Chiarella* v. *United States*, 445 U.S. 222 (1980), several Justices agreed that trading on misappropriated information would violate Section 10(b), even though the Court held (445 U.S. at 235-237) that that question was not presented in the case. See *id.* at 239 (Brennan, J., concurring); *id.* at 239-243 (Burger, C.J., dissenting); *id.* at 245 (Blackmun, J., dissenting). In other contexts, this Court has found similar breaches of a fiduciary duty to be fraudulent. See, *e.g.*, *United States* v. *Carter*, 217 U.S. 286, 305-310 (1910); *Wardell* v. *Railroad Co.*, 103 U.S. 651, 654-659 (1880).

[9]See also *Dirks* v. *SEC*, *supra*, slip op. 12, quoting *Mosser* v. *Darrow*, 341 U.S. 267, 272 (1951) ("[T]he transactions of those who knowingly participate with the fiduciary in such a breach are 'as forbidden' as transactions 'on behalf of the [fiduciary] himself.' ").

The contrast with *Walton* v. *Morgan Stanley & Co.* 623 F.2d 796 (2d Cir. 1980), cited by petitioner (Pet. 20) and discussed by the Court in *Dirks* (slip op. 15 n.22), is instructive. In *Walton*, an investment banking firm received nonpublic information from a *non*-client—a possible target of a takeover by one of its clients. The firm then traded on that information after its client had *abandoned* its takeover plans. By contrast, petitioner traded on information misappropriated from both the investment banking firm and its clients at a time when the clients had a very substantial interest in preserving its confidentiality. (We note that *Walton* was decided under Delaware state law. 623 F.2d at 798.)

op. 18). Petitioner's misappropriation and its fraudulent character were fully alleged in the indictment.

Petitioner asserts (Pet. 13-21) that his conduct did not violate Section 10(b) and Rule 10b-5 because he and his accomplices defrauded only the investment banks and their clients and not any person with whom they engaged in securities transactions. In this connection, petitioner alludes to the principle (see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975)) that a civil damages action under Section 10(b) may be brought only by a purchaser or seller of securities. Pet. 18 n.24. But as the Court has expressly held, this limitation has no application to a government enforcement action. See, *e.g.*, *Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 751 n.14; *United States* v. *Naftalin, supra*, 442 U.S. at 774 n.6.

Petitioner's fraud plainly occurred—to quote the language of the statute and the rule—"*in connection with* the purchase and sale of securities" (emphasis added). First, the misappropriated information concerned the investment banks' clients' proposed purchases of securities. Second, as the court of appeals pointed out (Pet. App. 47a), petitioner and his co-conspirators wronged those clients with respect to the client's purchases of securities. Third, the conspirators misappropriated the information for the "sole purpose" of "purchas[ing] shares of the target companies" (*id.* at 48a). See *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971) (emphasis added) (Section 10(b) reaches "deceptive practices *touching* [the] sale of securities as an investor"); *United States* v. *Naftalin, supra*, 441 U.S. at 772 ("The statutory language does not require that the victim of the fraud be an investor."). See also *id.* at 776 ("the welfare of investors and financial intermediaries are inextricably linked—frauds perpetrated upon

either business or investors can redound to the detriment of the other and to the economy as a whole").[10]

Petitioner avoids discussing the language of the statute or the rule. Instead, he relies almost exclusively (see Pet. 15-17) on *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977). But the crux of the holding in *Santa Fe Industries* is that mere unfairness in a securities transaction, "without any deception, misrepresentation, or nondisclosure," does not violate Section 10(b) and Rule 10b-5. 430 U.S. at 476. Petitioner was specifically charged with, and convicted of, deception, misrepresentation, and nondisclosure. See pages 3-4, *supra*. As this Court recently said in discussing *Santa Fe Industries*, "[i]n an inside-trading case * * * fraud [in violation of Rule 10b-5] derives from the 'inherent unfairness involved where one takes advantage' " — as petitioner plainly did — "of 'information intended to be available only for a corporate purpose and not for the personal benefit of anyone.' " *Dirks* v. *SEC, supra*, slip op. 7 (citation omitted).[11] Contrary to petitioner's suggestion, *Santa Fe Industries* does not give courts a license to decide that certain conduct, although covered by the express terms of Section 10(b) and Rule 10b-5, is better left to state regulation.

Petitioner also urges (Pet. 19) that the court of appeals' ruling may have an adverse impact on securities analysts whose business it is to seek out and piece together information not widely disseminated in the market. But the line

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[10] *Naftalin* concerned Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), but as petitioner appears to acknowledge (see Pet. 18 n.24), the differences between Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 (see generally *Aaron* v. *SEC*, 446 U.S. 680, 687-702 (1980)) are not material to this discussion.

[11] The Court also firmly stated in *Dirks* that Rule 10b-5 does not distinguish between "inside" information and "market" information like that on which petitioner traded. Slip op. 10 n.15.

between such legitimate activities and the misappropriation of information of which petitioner was guilty is scarcely hard to discern. As the district court instructed the jury in this case: "To misappropriate means to take and use something without the authority of the rightful owner. It is the equivalent of steal" (Pet. App. 117a). Moreover, scienter is an element of a violation of Section 10(b). *Aaron* v. *SEC*, 446 U.S. 680, 695 (1980). The legitimate use of information will, therefore, not be chilled by the prosecution of practices like those of petitioner and his confederates.

c. Finally, this is not an appropriate case in which to decide the question petitioner urges on the Court. Pursuant to its rulemaking authority under Section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(e), the SEC has recently promulgated Rule 14e-3(a), 17 C.F.R. 240.14e-3(a), which prohibits persons other than the bidder from trading on material nonpublic information concerning a planned tender offer where that information has been acquired from the bidder or a person associated with the bidder. Future litigation over conduct like petitioner's will, therefore, focus not only on Section 10(b) but also on the Commission's authority under Section 14(e) and this more specific rule. See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468 (1969) (Sections 10(b) and 14(e) are not coextensive).

3. Petitioner further contends (Pet. 21-25) that he did not have fair notice that his conduct violated the securities laws. But as the court of appeals explained, petitioner and his co-conspirators could have had no possible doubt that their conduct was fraudulent. See Pet. App. 47a (citing cases) ("deceitful misappropriation of confidential information by

a fiduciary * * * had consistently been held to be unlawful"). See also pages 9-10, *supra*.[12] Petitioner does not contend that he actually thought his conduct was legal, and the elaborate measures he and his co-conspirators took to conceal their enterprise make it clear that they knew their conduct was illegal. In addition, at the time petitioner and his confederates were engaging in their scheme, the SEC had brought a number of enforcement actions against persons who had engaged in similar conduct;[13] in fact, the evidence at trial showed that in 1974, one of the conspirators brought to petitioner's attention a newspaper account of a Commission enforcement action against persons who had engaged in similar conduct. Petitioner's reaction was to say that the account showed that he and his co-conspirators

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[12]See also *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 11 n.7 ("misappropriation is a 'garden variety' type of fraud").

[13]See, *e.g.*, *SEC* v. *Sorg Printing Co.*, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 94,767 (S.D.N.Y. Aug. 21, 1974) (consent decree) (financial printer engaged by bidder company and several of the printer's employees purchased stock in target company prior to public announcement of tender offer); *SEC* v. *Healy*, No. 74-4305 (S.D.N.Y. Nov. 18, 1974) (consent decree) (employees of bidder company purchased target company securities before the tender offer was announced); *SEC* v. *Primar Typographers, Inc.*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 95,734 (S.D.N.Y. Sept. 16, 1976) (consent decree) (employees of financial printer engaged by bidder company obtained, during the course of their employment, information regarding pending tender offers and, on that basis, purchased target company stock prior to announcement of tender offer); *SEC* v. *Stone*, No. 78-4259 (S.D.N.Y. Sept. 11, 1978) (consent decree) (officer of subsidiary of bidder company purchased shares in target company prior to announcement of proposed acquisition).

Consent decrees are a means of giving notice to the securities industry of the kind of practices considered unlawful. See generally *Arthur Lipper Corp.* v. *SEC*, 547 F.2d 171, 181 n.7 (2d Cir. 1976), cert. denied, 434 U.S. 1009 (1978).

were unlikely to be severely punished. J.A. 233-238. In these circumstances, the fact that this Court has not yet squarely held that petitioner's conduct violated Section 10(b) and Rule 10b-5 did not constitute a lack of fair notice; if it did, no defendant could ever be prosecuted under a statute the interpretation of which has not been definitively settled by this Court. See *United States* v. *Feola*, 420 U.S. 621, 685 (1975) (an "interpretation [of a statute] poses no risk of unfairness to defendants [and] * * * is no snare for the unsuspecting" when "the perpetrator * * * knows from the very outset that his planned course of conduct is wrongful [and] * * * unlawful").[14]

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[14]Similar claims of lack of fair notice in Section 10(b) prosecutions have consistently been rejected where, as here, the conduct in question was plainly fraudulent. See, *e.g.*, *United States* v. *Brown*, 555 F.2d 336, 339-340 (2d Cir. 1977); *United States* v. *Persky*, 520 F.2d 283, 286-288 (2d Cir. 1975). See also *United States* v. *Naftalin*, *supra*, 441 U.S. at 778-779; *SEC* v. *Shapiro*, 494 F.2d 1301, 1308 (2d Cir. 1974).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 82-1653

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

JAMES MITCHELL NEWMAN,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY TO BRIEF FOR THE UNITED STATES IN OPPOSITION

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REPLY TO BRIEF FOR THE UNITED STATES IN OPPOSITION

The Government's Opposition to the Petition for a Writ of Certiorari demonstrates why certiorari should be granted. The Opposition makes it clear that the Government will view a denial of certiorari here as a mandate to continue prosecuting citizens for both mail fraud and securities fraud on theories that stretch beyond the boundaries intended by Congress and articulated by this Court.

I. THAT SOME LOWER COURTS HAVE REMOVED VIRTUALLY ALL LIMITATIONS ON THE USE OF THE MAIL FRAUD STATUTE TO PROSECUTE COMMON BREACHES OF DUTY ARGUES FOR, NOT AGAINST, REVIEW BY THIS COURT.

The crux of the Government's argument against review of petitioner's mail fraud conviction is that "the courts of appeals have repeatedly upheld the application of the mail fraud statute to breaches of fiduciary duty

like that aided and abetted by petitioner."[1] (Opposition at 8.) While the courts of appeals have hardly been uniform in their treatment of the issue raised by the Petition,[2] it is precisely the liberties taken in many lower court decisions that provide a compelling reason for this Court to review the mail fraud issues presented by petitioner. These cases, which culminated in the Second Cir-

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[1] The Government improperly places far too many cases in that category. Respondent provides a long string-cite of cases which purportedly uphold mail fraud convictions like that of petitioner. (Opposition at 8 n.6.) The bulk of these cases involve either the special duties owed to the public by public officials, or kickback arrangements which inevitably result in the diversion of money from an employer or other intended recipient. As noted in our Petition, these factors remove these cases from the category of pure breaches of duty to a private employer with no actual or contemplated pecuniary harm, into which petitioner's case falls. (*See* Petition at 10-11.)

[2] The Fifth Circuit has given the mail fraud statute much more limited breadth than the Second Circuit with regard to the prosecution of breaches of duty of no economic consequence. In *United States v. Ballard*, 663 F.2d 534 (5th Cir. 1981), *reh'g denied*, 680 F.2d 352 (5th Cir. 1982) (per curiam), the Fifth Circuit reversed mail fraud convictions based on alleged breaches of fiduciary duty by employees of oil distribution companies, where the evidence failed to show any economic harm to the companies as a result of the breaches. *Ballard* involved a scheme to pay secret kickbacks from profits generated by the sale of petroleum at a time when oil prices were subject to federal regulation. Because the companies had sold the oil at the maximum price allowable under the federal regulations, the kickbacks received by the employees for causing the oil to be sold to certain purchasers resulted in no economic harm to the employers, and the employees' failure to disclose receipt of the kickbacks was not material. 663 F.2d at 541-42. The court stressed that "[a]ll fiduciary breaches, it seems, could be found to involve the loss of an intangible—an employee's faithful and honest services. But, as the Seventh Circuit has stated, '[n]ot every breach of [every] fiduciary duty works a criminal fraud.'" *Id.* at 540, *quoting United States v. George*, 477 F.2d 508, 512 (7th Cir.), *cert. denied*, 414 U.S. 827 (1973). *See also United States v. Bethea*, 672 F.2d 407, 414 (5th Cir. 1982) (violation of government conflict-of-interest regulation does not constitute mail fraud "absent some detriment to the government").

cuit's decision below, have transformed the mail fraud statute into one of virtually boundless application to common breaches of duty. The decision below is the most radical extension of the scope of the statute to date, since it ignored altogether this Court's historic requirement that there be some actual or potential pecuniary loss to the victim from the alleged mail fraud.[3]

The Government recognizes (Opposition at 7 n.5) that this Court last addressed this issue nearly sixty years ago in *Hammerschmidt v. United States*, 265 U.S. 182 (1924). In that case the Court said that the mail fraud statute was limited to schemes with "the wrongful purpose of injuring one in his property rights" (*id.* at 188) and noted that the statute "should be confined to pecuniary or property injury inflicted by a scheme to use the mails for the purpose." (*Id.* at 188-89.) The Government belittles the significance of this precedent by mischaracterizing the *Hammerschmidt* decision. (Opposition at 7 n.5.) Contrary to the Government's contention, *Hammerschmidt* nowhere suggested that "property injury" might include dishonesty of an employee to his employer which neither results in, nor is responsible for, any economic loss.

The decision below ignored the boundaries articulated in *Hammerschmidt*, as have other courts with increasing

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[3] Contrary to the Government's implication (Opposition at 7), petitioner does not contend that a mail fraud conviction requires proof of *actual* economic harm or injury to the victim, but recognizes that contemplated economic injury also falls within the statute's proscription. (*See* Petition at 8-9.) Petitioner's conviction, however, was based on a jury instruction that contained no requirement of actual or contemplated pecuniary injury:

> "[I]t is not necessary in a mail fraud case based upon a breach of fiduciary duty by a private employee for the government to prove direct, tangible, economic loss to the victim, actual *or contemplated*. The object of a fraudulent scheme need not be the deprivation of a tangible interest, such as money, from another. Schemes designed to deprive [their] victims of intangible rights also violate the mail fraud statute." (App. at 123a, emphasis added.)

extremism over the past several years. The issue warrants revisitation by this Court.

II. THE GOVERNMENT'S VIEW THAT *DIRKS v. S.E.C.* IMPLICITLY DECIDES THE MISAPPROPRIATION ISSUE LEFT OPEN IN *CHIARELLA v. UNITED STATES* MAKES REVIEW OF THAT ISSUE IN THIS CASE ESSENTIAL.

The securities fraud issue presented by the Petition is straightforward.[4] Neither petitioner nor his colleagues had or breached any duty cognizable under the securities laws to those from whom petitioner bought securities. The sellers all were, and remain, strangers to the purchasers. Moreover, neither petitioner nor his colleagues misappropriated any information from any entity or person who owed a duty of disclosure or abstention to the sellers of those securities. The Government's theory is that they misappropriated information from their employers. But the employers and their clients had no duty to those sellers either. They undoubtedly could have law-

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[4] The Government suggests that review of petitioner's securities fraud conviction is unnecessary because his sentence on that conviction is concurrent with his sentence on the mail fraud counts. (Opposition at 9.) However, petitioner's conspiracy conviction, for which he was fined in addition to receiving a concurrent prison sentence, depends on the securities fraud issue as well. The Government's contention (Opposition at 9 n. 7) that the conspiracy conviction would stand even if the securities fraud conviction were reversed is wrong. In *Yates v. United States*, 354 U.S. 298, 312 (1957), this Court held that where a single conspiracy to commit separate offenses is charged, "the proper rule to be applied is that which requires a verdict to be set aside in cases where the verdict is supportable on one ground, but not on another, and it is impossible to tell which ground the jury selected." Here, the district court specifically charged the jury that it could find petitioner guilty of conspiracy if it found that he had participated in a conspiracy to commit *either* mail fraud *or* securities fraud and that it need not find a conspiracy to commit both offenses. (App. at 102a-103a.) Because the jury's verdict may have rested solely on a finding that petitioner conspired to commit securities fraud, reversal of the conspiracy conviction would be required if the securities fraud conviction were reversed.

fully purchased the same securities from the same persons without disclosing the impending tender offers. The question presented, then, is whether, because of an earlier "misappropriation" of information by his colleagues from their employers, petitioner can be prosecuted for fraud in a securities transaction in which no party was owed a special duty of disclosure or was affirmatively misled.

Petitioner believes the misconduct charged here—breach of an employee's duty of honesty to an employer not engaged in related securities transactions—is simply not the type of conduct addressed by Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 thereunder.[5] The Government has not alleged that petitioner owed any duty of disclosure to other parties to the securities transactions in which he engaged. (*See* App. at 59a-61a.) The jury was not charged with assessing whether petitioner defrauded "the persons from whom [he] purchased stocks." (*See* Petition at 14 n.17.) Indeed, the Second Circuit specifically held that petitioner could be convicted even though none of the parties the Government had alleged he defrauded was a purchaser or seller of securities in any transaction with petitioner. (App. 44a.) The only persons allegedly defrauded were the employers of petitioner's colleagues, and their clients, neither of whom engaged in any securities transactions with him. In this context, petitioner's purchase of securities is significant only as a jurisdictional device to apply Section 10(b) to the alleged breach by employees of the duty of honest service to their employers. This is an expansion of the concept of fraud "in connection with the purchase or sale

[5] *Cf.* Recent Developments, *Securities Regulation—Retributive or Remedial: What is the Objective of Imposing Criminal Sanctions in Section 10(b) Actions Under the 1934 Securities Exchange Act?* 8 J. CORP. L. 527, 528 (1983) ("[The *Newman*] decision is significant because many activities, which otherwise would have gone unpunished due to a lack of duty between the buyer and seller, will now be punishable under section 10(b) and rule 10b-5").

of securities" far beyond any application this Court has allowed.

The Government's theory in this case, and the grounds for the decision of the court below, are in direct conflict with several of this Court's recent decisions. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), this Court held that Section 10(b) could not be substituted for a longstanding statutory framework under state law governing the duties claimed to have been breached, even if those breaches arose in the context of a securities transaction. (*See* Petition at 15-17.) The Government addresses this issue only by asserting that *Santa Fe* "does not give courts a license to decide that certain conduct, although covered by the express terms of Section 10(b) and Rule 10b-5, is better left to state regulation." (Opposition at 12.) Obviously, this response begs the key question presented in *Santa Fe*: Whether a breach of duty under state law ancillary to (or, as here, almost unrelated to) a securities transaction is "covered by the express terms of Section 10(b) and Rule 10b-5." Petitioner believes that an employee's "misappropriation" of information from his employer does not fall within the antifraud provisions of the securities laws.

The conflict with this Court's decision in *Chiarella v. United States*, 445 U.S. 222 (1980), is even more manifest. In *Chiarella*, this Court held that Section 10(b) created no duty to the market at large to disclose nonpublic material information or refrain from trading in affected securities. The "duty" analysis in *Chiarella* has been virtually ignored in petitioner's case.

The Court reaffirmed the duty analysis of *Chiarella* in its recent decision in *Dirks v. S.E.C.*, No. 82-276 (July 1, 1983). *Dirks*, like *Chiarella*, emphasized that any securities law duty that might prohibit trading without disclosure of material nonpublic information arises from the relationship between the purchaser and seller of securities. The *Dirks* Court reiterated that "there is no general

duty to disclose before trading on material nonpublic information" (slip op. at 6), and that any such duty as does exist must arise from a special relationship between the parties to the transaction (*id.* at 7, 10).[6]

Instead of coming to grips with the inconsistency between its position and the duty analysis of *Chiarella* and *Dirks*, the Government claims that in *Dirks* the Court "*implicitly* recognized that liability could be imposed for 'misappropriat[ing] * * * information,' (slip op. 18)." (Opposition at 10, emphasis added.) This assertion misconstrues *Dirks*. At most, the Court's reference to "misappropriation" in *Dirks* was to make it clear that the "misappropriation" issue left undecided in *Chiarella*, 445 U.S. at 236, was not presented or decided in *Dirks* either. The Government's Opposition leaves no doubt that if certiorari is denied the Government will continue to bring prosecutions on the "misappropriation" theory, claiming support not merely from its suggestions of "implicit recognition" of the validity of this theory in *Dirks*, but also from the very decision petitioner here seeks to have reviewed.[7] This Court should not countenance such a patent misuse of its earlier opinion.

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[6] *See, e.g.*, Pitt & Ain, *"Dirks" Deals Blow to SEC Insider Trading Program*, Legal Times (July 11, 1983) at 10, 15:

> "On balance . . . the *Dirks* decision tends to vitiate, rather than to confirm, the 'misappropriation' theory. After all, *Dirks* makes clear that, in order for a person who trades on the basis of confidential nonpublic corporate information to be held liable under Rule 10b-5, where that person does not affirmatively misstate any facts or induce any trading transactions, the trader must be under a duty to disclose, as embodied in 'a specific relationship between the shareholders and the individual trading on inside information' . . . ."

[7] In fact, the S.E.C. has begun to take this position generally in Rule 10b-5 litigation. In its post-trial brief in *S.E.C. v. Lund*, Civ. Action No. 81-0371 MML(Kx) (C.D.Cal.), the S.E.C. wrote that: "In *Dirks* . . . the court inferentially supported the misappropriation theory in its opinion. *Dirks v. S.E.C.*, slip op. at 18. The misappropriation theory has been adopted by the Court of Appeals for the Second Circuit in *United States v. Newman* . . . . It is significant that no Justice of the Supreme Court has expressed disagreement with the misappropriation theory." (*Id.* at 7-8.)

Finally, the Government's Opposition fails to recognize the implications to the broader securities marketplace of the decision below. As the Court noted in *Dirks*, the whole securities marketplace will suffer unless market professionals and analysts "have some guidance as to where the line is between permissible and impermissible disclosures and uses . . . ." (Slip op. at 11 n.17.) The Government attempts to minimize the uncertainty created by competing views of the applicability and breadth of the "misappropriation" theory of Section 10(b) liability. (Opposition at 12-13.) The truth is otherwise. Absent clarification by the Court, a cautious market professional concerned for any reason that information he has obtained may have come from unauthorized disclosures will have to abstain from trading on, or disseminating, that information. This is because even if no duty of disclosure otherwise arises under the standards set forth in *Dirks*, the Government's misappropriation theory could still support a fraud prosecution.

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For all the reasons set forth herein and in our Petition, this Court should grant the requested Writ of Certiorari.

Respectfully submitted,

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